Inflation Report

December 2001

Banco de la República
(Central Bank)
Colombia

Presentation, summary and conclusions

Review of inflation to december 2001

- Annual consumer inflation was 7.6% in December 2001, running 0.4 percentage points below the 8.0% target set by the Banco de la Rep˙blicaís Board of Directors, and 1.1 points lower than a year earlier. Over the past 32 months annual consumer inflation has been 10.0% or less.

- The rate of inflation in December 2001 turned out exactly as the Bankís Economic Studies Division (SGEE) had predicted in the December 2000 Inflation Report.

- Fourth-quarter inflation in 2001 (0.6%) was 3 percentage points lower than a year earlier (0.9%), largely because of slower price rises in the groups of entertainment, culture and recreation, transport and communications, and diverse expenses, and despite higher rises in some food items.

- The food and services group continued to drive price growth over the fourth quarter. Food inflation came mostly from the year-end increase in the price of potatoes, given this stapleís weight in the food basket. Though beef prices did not go up in the fourth quarter, their climb during the previous quarters made beef the biggest contributor to inflation for the year as a whole. Among services, the fastest rises were in water supply, sewerage, imputed rent, and waste collection.

- No inflationary pressures came from demand in the final months of 2001, to judge by lower annual inflation in the groups of culture and entertainment, diverse expenditures, and clothing.

- Over the fourth quarter, inflation in tradables continued to fall, as it had been doing almost without a break since mid-2000, thanks to decreasing devaluation. And inflation in nontradables, which had been on the rise since March 2001, dropped slightly

- Core inflation, like headline inflation, behaved satisfactorily in 2001. In December, the core indicators averaged 6.7%, down from 7.0% in September and from 8.4% at the end of 2000, and none of them stood higher than either the headline or target rate.

- Producer inflation, too, performed well, running at 6.9% in December 2001, down by 4.1 percentage points on a year earlier and by 1.1 points on September. The fourth-quarter drop resulted from slower annual price rises in domestically produced and consumed goods and imports; by ISIC industrial activity, mining and manufacturing contributed most to the drop.

- No major inflationary pressures are expected in 2002. The evolution of consumer prices will benefit from moderate devaluation and sluggish world demand, which will be reflected in lower inflation in the main internationally traded commodities, including fuel. Although domestic demand is expected to pick up, ample available capacity precludes any pressure from this source.

✠ The possibility of pressure from food prices cannot however be completely overlooked. The holding-back stage in cattle breeding is expected to extend into 2002, reducing the supply of beef and raising meat prices. Potato prices, which went up in December, are likely to remain high over part of 2002, because of a reduction in supply resulting from low prices in the second and third quarters of last year. Nor can the likelihood of price rises in food staples as a whole be ruled out, for there may be a recurrence of the climatic conditions known as the NiÒo by the end of the year. Inflationary pressure is also expected from public services, particularly water supply and sewerage, since the gradual dismounting of utility subsidies should continue during 2002.

✠ Annual inflation is forecast to average 5.8% in the fourth quarter of 2002, according to the central path of the transmission-mechanism model. Combining inflation forecasts from different models gives an inflation of 6.4% by December 2002, the same figure as predicted three months ago.

✠ This Report also presents a first forecast for the fourth quarter of 2003. The central path of the transmission-mechanism model shows inflation declining over the year to an average of 3.9% in the fourth quarter.

✠ Lower inflation in 2002 and 2003 will be largely the outcome of a predicted absence of major inflationary pressures from demand, since expected economic growth should be easily accommodated by available installed capacity.

✠ The central inflation forecast for 2002 has an upward-biased risk balance, which indicates the possibility of greater-than-expected inflationary pressures, owing to uncertainty about the behavior of food prices and the exchange rate.

✠ Core inflation is expected to keep on falling in 2002. Measured as the average of the three indicators currently used by the Bank, it is projected by single-equation models to stand at 5.6% in December 2002. This is close to the figure for non-food CPI (5.3%) projected by the transmission-mechanism model. The core-inflation forecast comes with an upward-biased risk balance, as in the case of headline inflation and for the same reasons.

✠ GDP grew at an annual rate of 1% over the third quarter, more slowly than in the previous two quarters because of weakening demand of every kind, particularly external and investment demand. Consumption demand benefited from a pick-up in government consumption and higher household demand for durable and semidurable goods.

✠ Judging from several real-activity indicators, the pace of economic growth may have improved slightly over the fourth quarter, thanks particularly to higher domestic demand. Recovery in November in such factors as loans for building or buying housing and construction licenses points to faster growth in private construction in late 2001. Given this sectorís highly labor-intensive nature, its continued recovery would give a strong boost to job creation and hence to private consumption. Data on car sales to November show a considerable rise on levels registered in the previous 24 months. Retail sales and electricity consumption also behaved tolerably well.

✠ A number of current circumstances favor growth in early 2002 and could make up for a weakening in exports. They include, notably, low interest rates, exchange-rate stability, lower net capital outflows, a recent reduction in unemployment, and tax incentives for investment in low-income housing. By improving consumer and investor expectations, they could strengthen domestic demand.

✠ The Board of Directors continued to ease monetary policy over the fourth quarter of 2001, thanks to satisfactory inflation results and the fact that projections are in line with the set targets. The Bank cut interest rates three times in the fourth quarter, by a total of: 75 basis points in the auction expansion rate, bringing it down to 8.5% by the end of the year; 75 points in the auction contraction rate, down to 7.5%; 100 points in the Lombard expansion rate, down to 12.25%; and 50 points in the Lombard contraction rate, down to 6.25%.

✠ Besides reducing intervention rates, the Board of Directors provided permanent liquidity to meet higher year-end needs by buying international reserves and through final purchase of public-debt securities, amounting in all to 993 billions pesos.

✠ The exchange rate stood at 2,291 pesos to the dollar at the end of 2001, with an average devaluation of 5.4% and a year-end devaluation of 2.8%. Average devaluation, figure, which is lower than the difference between the domestic and external interest rates, is largely accounted for by foreign financing of the fiscal deficit and by smaller net outflows of private capital.

✠ The monetary base moved closer to its reference line during the fourth quarter, ending the year with the 20-day average running on the reference line, and the 45-day average slightly below the line. M3, the broader measure of money supply, continued to expand over the quarter, registering a 10.5% annual growth in December, 1.6 percentage points higher than in September. This expansion came from a rise in checking and savings accounts, and especially from a strong increase in Repo operations with the Treasury, which have the advantage of not being subject to reserve requirements.

✠ Greater availability of financial savings went to swell the financial intermediariesí portfolio of Treasury paper, considerably increasing public debt, without breaking the recovery trend that the financial sectorís loan portfolio has been showing for several quarters. But this recovery continued to be very slow at the end of 2001, the gross nominal portfolio registering a 2% annual growth. By type of loan, the strongest recovery during the fourth quarter was in consumer loans, which expanded at an annual rate of 10.4%, much faster than in the third quarter (5.8%).

✠ The drop in inflation over recent month, to less than 8%, is a positive factor in that it lowers inflation expectations, which can help to reduce the size and number of price adjustments in early 2002. As a matter of fact local and foreign analysts substantially reduced their inflation forecasts for 2002, even before knowing the inflation figure for December.

✠ Available forecasts suggest that Colombia is set to meet the 6% inflation target for 2002 by the end of the year. Similarly, medium-term forecasts are compatible with achieving an inflation rate within the range of 4%-6% announced for 2003. Analysis of real economic activity points to recent improvements in some indicators of domestic demand. Economic recovery is expected to continue all through 2002, without compromising attainment of the inflation targets, because the economy still has excess capacity, and also because greater credibility of monetary policy has brought down inflation expectations. Moreover, the monetary baseís moving average has recently moved close to its reference line, and the external situation is not expected to undergo any changes likely to jeopardize meeting the inflation targets.

- On the basis of the foregoing considerations, the Board of Directors of the Banco de la Rep˙blica has decided to reduce the maximum and minimum auction expansion and contraction rates by 0.5 percentage points. The Lombard expansion rate has also been reduced by 0.5 percentage points and the Lombard contraction rate by 0.25 points. These modifications are compatible with the inflation forecasts indicated above.

- Accordingly, the Banco de la Rep˙blicaís intervention rates now stand as follows: the Lombard expansion rate at 11.75%, the Lombard contraction rate at 6.0%, the auction expansion rate at 8.0%, and the auction contraction rate at 7.0%.

The Board of Directors,

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Minister of Finance and Public Credit

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Inflation Report
December 2001

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A. Consumer Price Index

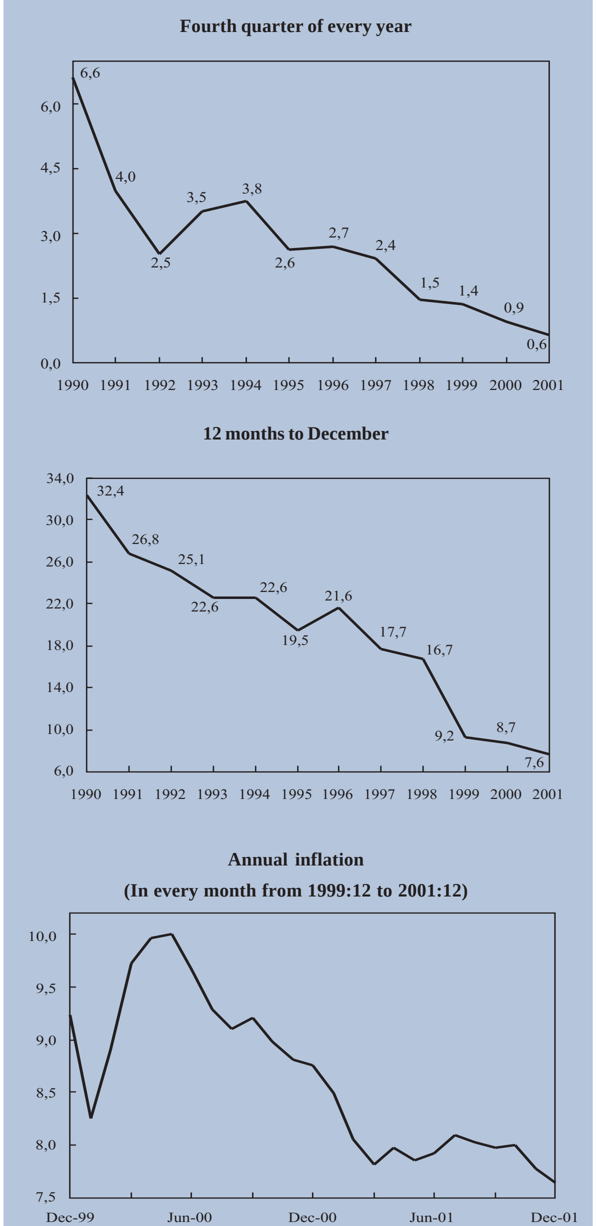
1. Overall behavior

Annual consumer inflation ended the fourth quarter of 2001 at 7.6%, down by 0.4 percentage points on three months earlier and by 1.1 points on December 2000 (Figure 1 and Table 1). It was the lowest rate in any month since 1970-when it stood at 6.8%-, and undershot the 2001 inflation set by the Banco de la República's Board of Directors by 0.4 percentage points.

Fourth-quarter consumer inflation tends to be seasonally low in Colombia but in 2001 it was lower than expected, running at 0.6%, compared with a predicted rate of about 0.9%, as in 2000. The drop was mostly produced by slower price growth in the entertainment, culture and recreation group: 0.1% in the fourth quarter of 2001, down from 3.9% in the fourth quarter of 2000. Clothing, diverse expenditures and transport also contributed to the drop.

Core inflation, like headline inflation, was satisfactory in 2001. In December, the three measures of core inflation regarded as most reliable by the Bank stood lower than in 2000 and well below the 8.0% inflation target for 2001, having dropped to the following levels: non-food Consumer Price Index to 6.5%, inflation nucleus to 7.4%, and CPI excluding food staples, fuel and public services to 6.1%. The three indicators were individually lower in December than in September, and their average dropped over this period from 7.0% to 6.7%. Moreover, the three core-inflation indicators ran below headline inflation over

Figure 1
Consumer Price Index
(Percentage change)



Source: National Statistics Agency (DANE). Calculations by Banco de la República.

TABLE 1
INFLATION INDICATORS
(ANNUAL PERCENTAGE CHANGE)

		Annual		
		Dec. 00	Sep. 01	Dec. 01
I.	**CPI**	8,7	8,0	7,6
	Food	7,4	10,6	10,5
	Housing	4,9	3,8	4,3
	Clothing	3,6	3,3	2,6
	Health care	10,3	10,8	10,9
	Education	9,4	10,4	10,2
	Entertainment, culture & recreation	11,7	11,2	7,1
	Transport	16,2	9,8	8,9
	Diverse expenditures	15,2	8,9	7,6
II.	**Core inflation 1/**	8,4	7,0	6,7
	Non-food CPI	9,3	6,9	6,5
	Nucleus **2/**	8,5	7,8	7,4
	CPI excl. food staples, fuel & public services	7,5	6,3	6,1
III.	**PPI**	11,0	8,0	6,9
	By economic use or destination			
	Intermediate consumption	10,9	8,6	5,8
	Final consumption	10,8	7,9	8,5
	Capital goods	10,8	5,0	5,7
	Building materials	12,9	9,6	7,4
	By origin			
	Domestically produced and consumed	10,6	9,1	7,7
	Imports	12,5	4,8	4,6
	Exports **3/**	6,4	(8,0)	(7,9)
	By industrial activity (ISIC)			
	Farming, forestry & fishing	6,0	6,8	7,6
	Mining	27,3	3,4	(1,3)
	Manufacturing	11,9	8,5	7,0

1/ The average of the three core-inflation indicators calculated by the Banco de la República.
2/ CPI excluding 20% of the weight of items showing the greatest price volatility between January 1990 and April 1999.
3/ Total PPI does not include exports. It is calculated from the weighted sum of domestically produced and consumed goods and imports.
Sources: Economic Studies Division (SGEE) of the Banco de la República, and DANE's PPI and CPI Lists.

the fourth quarter of 2001 (Table 1 and Figure 2). These core-inflation results augur well for meeting the 2002 inflation target of 6.0%.

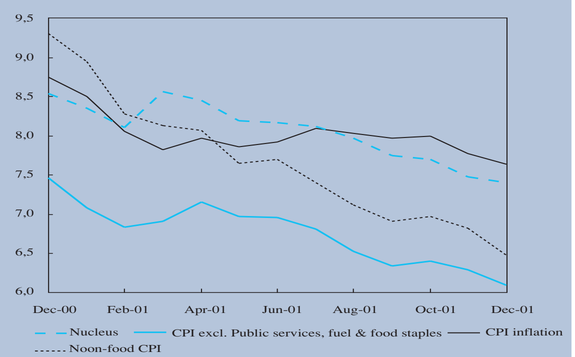
The highest accumulated rise in consumer prices in 2001 occurred in the city of Cúcuta (10.5%), followed by Montería (10.1%) and Neiva (9.5%), and the lowest in Pereira (7.0%), Bogotá (7.1%) and Medellín (7.1%) (Table 2). Relative to September, the only big increase in annual inflation was reported by Pasto, where the rate climbed from 7.4% in September to 8.1% in December.

Annual inflation was higher than average in the Atlantic Region cities of Barranquilla, Cartagena and Monteria, where food, health-care and transport prices rose by more than the average rate shown by the rest of the group of 13 cities considered.

2. Behavior of main CPI components

The fourth quarter of 2001 brought no great changes in the individual price trends of the CPI basket's eight groups of components, relative to the third. Thus, the group of entertainment, culture and recreation, representing a significant share (3.6%) of the basket,

Figure 2
Headline and Core Inflation
(Annual Percentage Change)



Source: DANE. Calculations by Banco de la República.

continued to show sharply falling prices, having broken in August a steadily rising trend more than a year long. The other groups that had registered declining annual inflation in the previous quarters-transport, diverse expenditures and clothing-also continued to do so in the fourth quarter (Figure 3). Similarly, in December the food and housing groups, which had shown rising annual inflation over much of the year, maintained the pace of price increase reported at the end of the third quarter.

Generally speaking, deflationary pressures in the fourth quarter continued to originate mostly from lower fuel prices and the ample availability of unused installed capacity. Higher demand did not therefore bring any large price rises in such items as entertainment, culture and recreation, clothing, diverse expenditures, rents and certain processed foods.

Likewise, inflation over the fourth quarter was largely driven by utility rates, owing to the dismantling of consumer subsidies, and by some non-processed-food prices. In the case of non-processed foods, beef prices, having risen substantially in the preceding quarters, registered slower growth in the fourth, as anticipated by earlier Reports. As a result, the food group showed a highly satisfactory price behavior in October and November. But, in December, large expected price rises in potatoes and other vegetables offset price stability in beef, causing a substantial increase in food inflation.

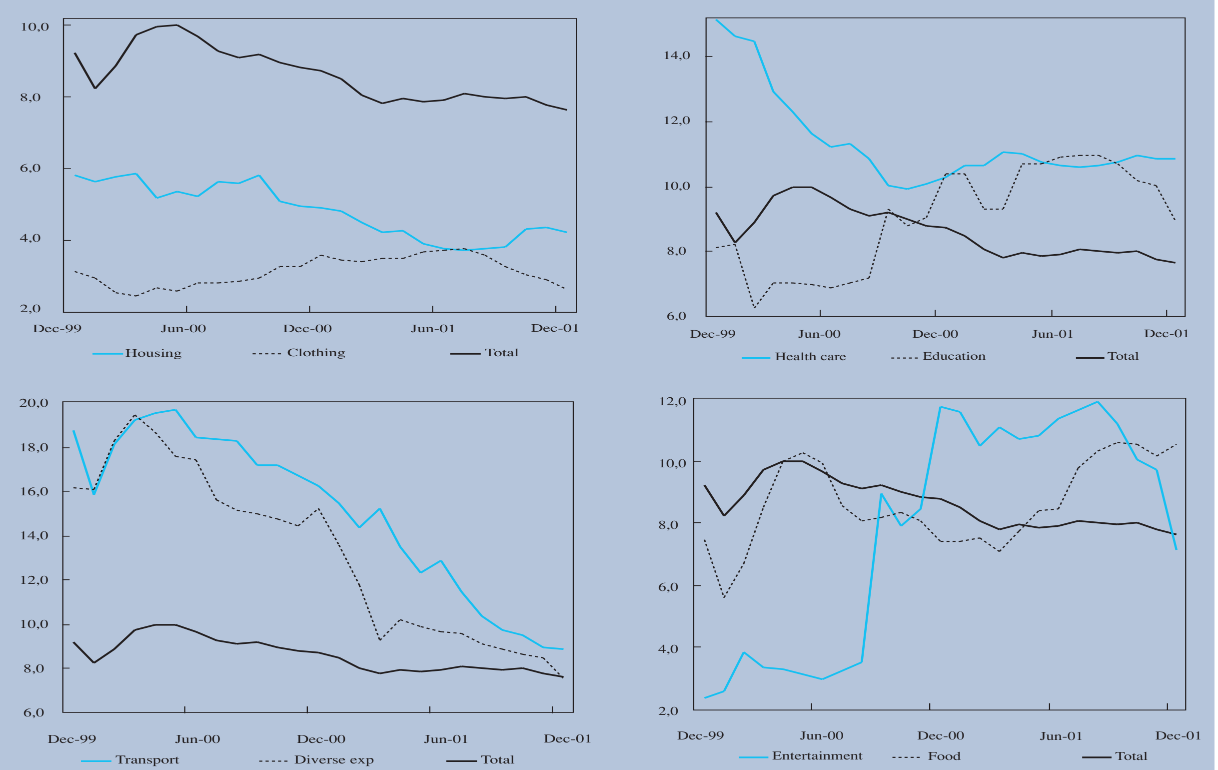
Breakdown of the CPI by specific items shows that the biggest contribution to fourth-quarter inflation came from the price behavior of peas, which reflected a seasonal drop in the supply of this product relative to the third quarter. Other big contributors were

Table 2
Consumer Price Index, Total and by City
(Percentage Change to December)

	Monthy			Annual		
	1999	2000	2001	1999	2000	2001
Total	0,5	0,5	0,3	9,2	8,7	7,6
Bogotá	0,4	0,5	0,3	9,2	8,9	7,1
Medellín	0,9	0,5	0,4	10,0	8,7	7,1
Cali	0,3	0,3	0,2	7,5	8,1	8,3
Barranquilla	0,7	0,4	0,7	9,7	8,1	9,2
Bucaramanga	0,5	0,4	0,7	10,1	9,6	8,4
Manizales	0,8	0,3	0,2	10,3	8,3	7,2
Pasto	0,1	0,5	0,5	10,9	10,5	8,1
Pereira	0,5	0,5	0,1	10,4	8,9	7,0
Cúcuta	0,9	0,3	0,6	10,0	10,5	10,5
Montería	0,6	(0,0)	0,3	8,6	9,8	10,1
Neiva	0,4	0,5	0,5	8,9	8,5	9,5
Cartagena	0,8	0,4	0,6	7,9	8,6	9,2
Villavicencio	0,5	0,1	0,7	8,0	7,8	8,1

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

Figure 3
Consumer Inflation, by CPI Group
(Annual Percentage Change)



Source: DANE. Calculations by Banco de la República.

public services, with water supply, sewerage and waste collection accounting once more for a large rise in quarterly inflation. The fourth quarter also saw a major price increase in carbonated and malt soft drinks, probably facilitated by production having become more highly concentrated in 2001 among a few firms (Table 3).

As regards accumulated inflation for the year as a whole, beef was the single biggest contributor (11.0%) to the rate registered in December 2001, while water supply, sewerage and waste collection, bus fares, milk and residential telephone services together accounted for 15.6%.

Deflationary pressures in 2002 are expected to be of the same type as in 2001. Specifically, no large price increases are expected in entertainment, culture and recreation, clothing and diverse expenditures, for

Table 3
Greatest Contributors to Fourth-quarter Consumer Inflation, 2001

Item	Fourth-quarter price change	Contribution to inflation	
		Points	Percentage
Total	0,6	0,6	100,0
Peas	29,9	0,1	8,5
Water supply, sewerage & waste collection.	2,9	0,1	8,2
Imputed rent	0,4	0,1	8,0
Carbonated and malt soft drinks	4,7	0,0	7,5
Medicines	2,3	0,0	7,3
Other	0,5	0,4	60,6

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

there will still be underused productive capacity to comfortably accommodate higher demand. So these groups should help to curb consumer inflation in 2002, as they did in 2002. Rents are not expected to rise by more than target inflation either, in view of a possible upturn in housing supply-particularly low-income housing-that should easily absorb any additional demand. Relative rent prices are currently at a historically low level and should remain so for some time longer, given their lengthy cycle (Figure 4). Lastly, education inflation should be lower in 2002 relative to 2001, because domestic demand is not expected to be very buoyant, and also because lower inflation in December 2001 relative to 12 months earlier will mean that fee adjustments authorized by law will be smaller.

The biggest sources of inflationary risk in 2002 will be food prices and utility rates. In the case of food prices, a new upturn is expected in the price of beef, particularly during the first half of the year, since the cattle-retention phase is very likely to extend into and all through 2002. Potato prices may also rise sharply early in the year, because of bad weather in the potato-growing regions and a reduction of planted area in the second half of 2001. Planted area was reduced in response to low prices over much of 200l. The dismantling of water-supply subsidies will continue to exert inflationary pressure in 2002.

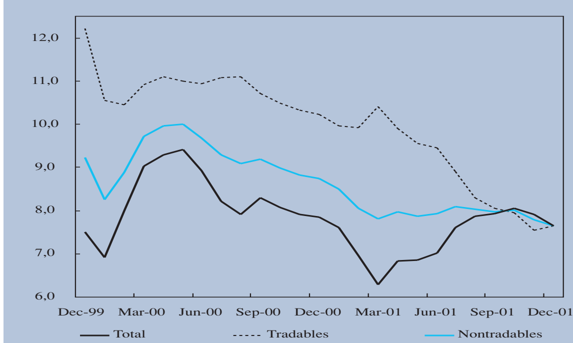
3. Alternate classification: tradable and nontradable goods

Figure 5 and Table 4 present annual consumer inflation under an alternate classification that divides the CPI basket into tradables[1] and nontradables, with the latter subdivided into indexed[2], flexible[3] and cyclical[4] items. As shown

FIGURE 4
RELATIVE RENT INFLATION
(ANNUAL PERCENTAGE CHANGE)

Source: DANE. Calculations by Banco de la República.

FIGURE 5
CONSUMER TRADABLES AND NONTRADABLES INFLATION
(ANNUAL PERCENTAGE CHANGE)



Source: DANE. Calculations by Banco de la República.

TABLE 4
CONSUMER TRADABLES AND NONTRADABLES INFLATION, BY COMPONENT

Item	12-month change		
	Dec. 2000	Sep. 2001	Dec. 2001
Total	8,7	8,0	7,6
Tradables	10,2	8,0	7,7
Nontradables	7,8	7,9	7,6
Indexed	7,6	6,3	6,1
Flexibles	9,3	6,0	8,5
Cyclicals	8,7	18,0	15,6

Sources: DANE's Lists. Calculations by Banco de la República, SGEE.

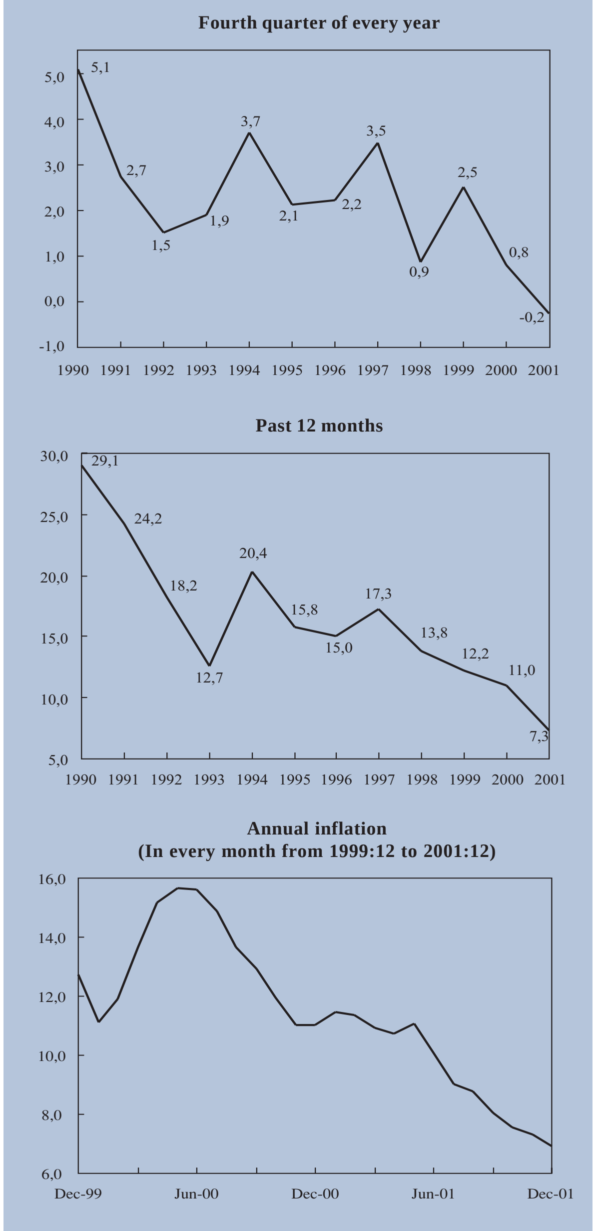
1 Tradables: textiles, footwear, tobacco, beverages, cereals, dairy produce, cooking fats, medicines, vehicles, electrical appliances, etc.

2 Indexed items: rent, fuel, utilities, education, transport, and other items.

3 Flexibles: root crops, plantains, vegetables, legumes, and fruit.

4 Cyclicals: meat, and meat products.

Figure 6
Producer Price Index
(Percentage Change to December)



Sources: DANE. Calculations by Banco de la República.

by Figure 5, the most notable development in the fourth quarter was the continued decline in tradables inflation, an almost unbroken trend that had started in mid-2000 and is connected with falling devaluation. In contrast, nontradables inflation broke the rising trend it had been showing since March 2001, by decreasing slightly in the fourth quarter.

Over the first half of 2001, tradables inflation ran higher than overall inflation while nontradables inflation ran lower, but the two began to converge in the third quarter and by the end of the year they both stood at the same level as the overall rate.

The 1.1 percentage-point drop in inflation relative to December 2000 was mostly accounted for by slower price growth in tradables, the rate falling from 10.2% in December 2000 to 7.7% a year later. The nontradables' price growth also decreased in the same period, edging down from 7.8% to 7.6% (Table 4). Among nontradable goods, cyclicals (meat, and meat products) stood out with a sharp rise in inflation, from 8.7% in December 2000 to 15.6% a year later; this rise was offset by lower inflation in indexed and flexible goods.

B. Producer Price Index

Annual producer inflation, as measured by the Producer Price Index (PPI), stood at 6.9% in December, 0.7 points below consumer inflation. It was 1.1 percentage points lower than in September and 4.1 points lower than in December 2000. Annual PPI inflation has been falling without a break since last May (when it was 11.1%), and its level in December 2001 was the lowest in any December since a similar index began to be recorded in 1970 (Figure 6 and Table 1).

Producer prices fell by 0.2% over the fourth quarter because of a 0.5% price drop in farm products and a 6.3% price drop in mining goods. These price drops in turn resulted from an accumulated negative devaluation of 1.8% over the quarter and from falling prices of internationally traded commodities. Manufacturing prices remained stable during the fourth quarter.

Breakdown of the PPI by origin of goods shows that the fourth-quarter fall in annual producer inflation was produced by slower growth both in the prices of domestically produced and consumed goods (7.7%

in December, down from 9.1% in September) and in import prices (4.6%, down from 4.8%)

Breakdown of the Index by ISIC economic activity reveals mining as the best performer, with a 12-month price variation of -1.3% in December, 4.7 percentage points lower than in September (3.4%). This plunge stemmed from slower price rises in oil extraction and in manufacturing. In contrast, inflation in the farming, forestry and fishing group rose over the year.

Producer-price inflation is not expected to be driven up by any great forces in 2002, essentially because imports PPI will be favored by low price pressure from internationally traded commodities, by stability in fuel prices, and by a devaluation expected to be moderate. Inflationary pressure on the Producer Price Index may come largely from the food group, because the cattle-retention phase, characterized by rising cattle and beef prices, will still be in progress, and also because of the possible recurrence of the Niño climatic condition in the second half of 2002.

II

Determinants of Inflation

A. Monetary Aggregates, Interest and Exchange Rates

1. Monetary-policy measures

In the last quarter of 2001, the Board reduced the Bank's intervention rates three times: on October 12 by 25 basis points; on November 9 by 50 points; and on December 14, the auction expansion and contraction rates by 25 points, and the Lombard expansion rate by 50 points but leaving the Lombard contraction rate unchanged (Table 5). With these cuts, the total reduction in the Bank's intervention rates in 2001 came to 350 basis points.

Year-end liquidity needs led to the Board's decision to provide permanent liquidity through the building-up of international reserves and final purchase of public-debt securities. Between September and December, such operations amounted to 993 billion pesos, with reserve-building options accounting for 833 billion, and purchase of Treasury paper (TES) for the remaining 160 billion (Table 6).

Table 5
Banco de la Repúlica's
Intervention Rates

Rate	12 Oct.	9 Nov.	14 Dec.
Lombard expansion rate	13,25	12,75	12,25
Auction expansion rate	9,25	8,75	8,50
Lombard contraction rate	8,25	7,75	7,50
Auction contraction rate	6,75	6,25	6,25

Source: Banco de la República.

The Bank also provided transitory liquidity during the fourth quarter, through one-day, 35-day and 91-day expansion Repos. One-day expansion Repos were underused, demand for them ascending to only 66% of the pre-set amount. Underuse was even more marked in the case of the 35-day Repos: demand totaled 251 billion pesos out of a pre-set amount of 800 billion. In contrast, 91-day expansion Repos were taken up completely (Tables 7and 8).

2. Monetary and credit aggregates

The monetary aggregates' behavior is analyzed below by examining movements in the monetary base, M1 money supply, broad money M3, and the financial system's loan balance.

Monetary base

The monetary base's average growth edged down from 11.4% in September to 11.1% in December, as a result of slower growth in reserves, which was partly offset by a small rise in cash expansion (Figure 7). For the year as a whole, average growth in the monetary base was 15.5%, reflecting an average growth of 21.1% in cash and 4.6% in reserves. The monetary base registered an annual growth of 8.8%, with cash expanding by 14.8% and reserves shrinking by 4.0%.

The reference line of the monetary base was modified in March and again in June, because of the effect that changes to the financial-transaction levy produced on base demand, and also because the series of monetary and credit aggregates were revised.

Table 6
Permanent Liquidity Supply(*)

operations	Reserve-building purchases		Treasury-paper	Total permanent liquidity supplied
	$ million	Billion pesos	Billion pesos	Billion pesos
September	0	0	20	20
October	100	233	100	333
November	140	323	40	363
December	120	277	0	397
Total	360	833	160	993

(*) Las cifras denominadas en dólares son millones y las cifras denominadas en pesos son miles de millones.
Source: Banco de la República..

Table 7
One-day(*) Expansion and Contraction Repos: Average use of Pre-set Amounts (Billions of Pesos)

	Expansion			Contraction		
	Pre-set amount	Use	% used	Pre-set amount	Use	% used
October	1.439	846	59,0	200	499	250,0
November	1.252	665	53,0	200	741	370,0
December	1.316	1.114	85,0	200	467	233,0
Fourth quarter	1.336	875	66,0	200	569	284,0

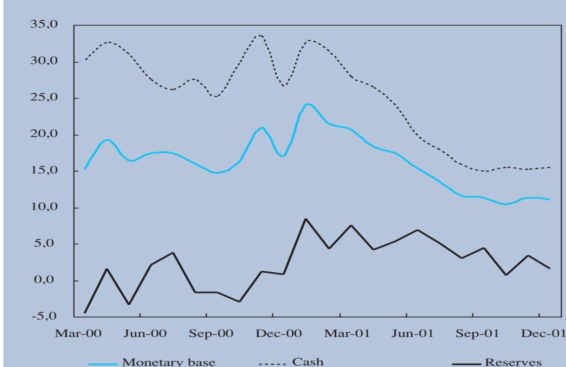
(*) Average
Source: Banco de la República.

Table 8
Use of 35-day and 91-day Expansion Repos: (Semi-permanent Liquidity) (Billions of Pesos)

	Repo maturity	Pre-set supply amount 1/	Demand
November 29	91 days	300	300
November 29	35 days	300	197
December 6	35 days	403	51
December 13	35 days	552	3
Total		1.100 **2/**	551

1/ The unused portion of pre-set amounts is added to the following week's pre-set amount, thus the amounts initially set for December 6 and 13 were 300 and 200 billion pesos, respectively.
2/ Sum of initially set amounts.
Source: Banco de la República.

Figure 7
Monetary Base and its Uses (Annual Percentage Change in Monthly Average)



Source: Banco de la República, SGEE.

As stated in the previous Report, the monetary base remained below the reference line in the third quarter (Figure 8). But this trend was reversed in the fourth quarter, particularly during the final weeks of the year, as cash expanded and made up for lower reserve demand (Figure 9). Reserve demand fell because liabilities subject to reserve (LSR) were below the levels implicitly envisaged in the reference line, and because the composition of such liabilities has shifted to those with lower rates of reserve. In particular, Treasury Repos[5], which are currently reserve free, have grown considerably as a proportion of LSR since mid-2000; in December 2001 they represented 4.0% of LSR, up from only 2.6% in December 2000 (Figure 10).

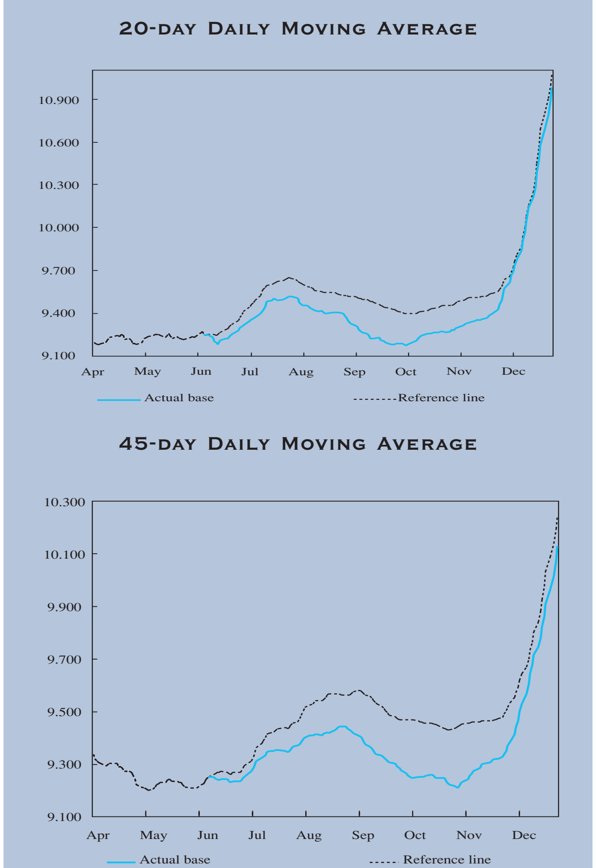
5 Very short-term loans extended by the Treasury to the financial system and backed by public-debt securities.

M1 money supply

Growth in M1 continued to weaken during 2001, extending a trend begun the previous November. It ended the year at 12.1% (far below the 30.5% expansion reached in 2000) and resulted from an increase of 14.8% in cash holdings and 10.0% in checking accounts (both significantly lower than their respective levels of 20.5% and 39.4% in 2000).

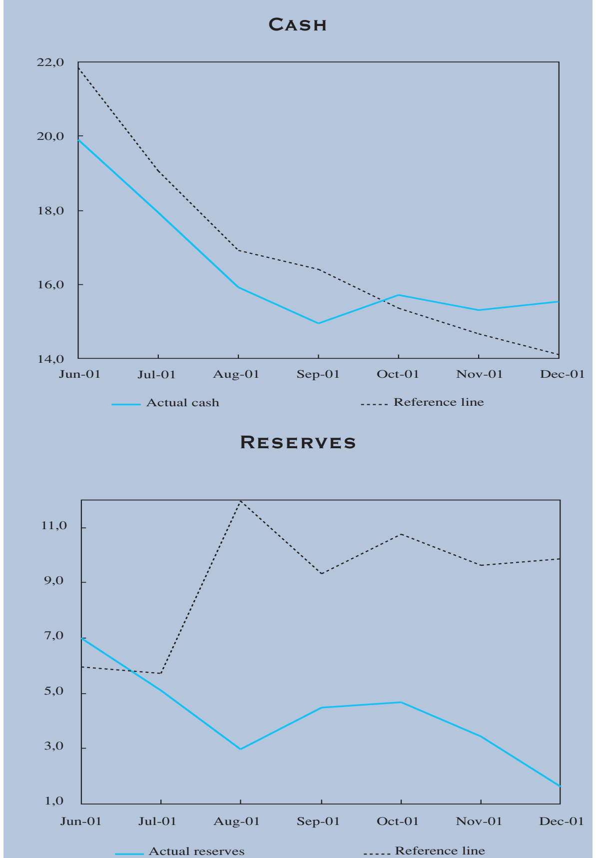
Declining growth in M1 demand is partly explained by the fact that, effective from March 2001, withdrawals from some savings accounts became

Figure 8
Monetary Base and Reference Line, 2001
(Billions of Pesos)



Source: Banco de la República, SGEE.

Figure 9
Cash and Reserves, and Their Reference Lines
(Annual % Change in Average Monthly Balance)



Source: Banco de la República, SGEE.

exempt from the financial-transaction levy (three per thousand). This measure led to a preference on the part of the public for saving accounts rather than cash holdings or current accounts.

The fourth quarter saw M1 growing a little more quickly, driven by faster expansion of both cash holdings (as indicated above) and checking accounts (Figure 11).

M3

Unlike M1, the broader measure of money supply (M3) recovered strongly all through 2001, ending the year with a growth rate of 9.7%, up from 2.8% twelve months earlier (Figure 12). This recovery did not necessarily reflect higher spending intentions on the part of the private sector, for it was largely the outcome of the faster expansion in Treasury Repos referred to above (Figure 13).

The fourth quarter brought no change in this trend. M3 continued to grow at an increasing pace, thanks to recovery in savings accounts, but mainly because of the surge in Treasury Repos. In December 2001, the average balance of Treasury Repos was 71.8% higher than in the previous December, whereas in September it had been 45,6% higher than 12 months earlier.

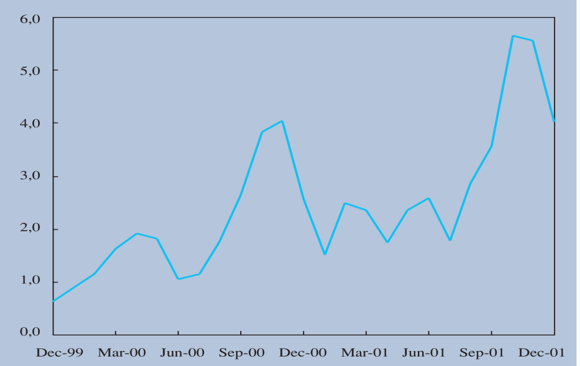
The average M3 multiplier fell over the fourth quarter, from 6,957 in September to 6,128 in December, owing to a rise in both the cash ratio (from 0.109 to 0.132) and the reserve ratio (from 0.051 to 0.054) (Figure 14).

Lastly, the Bank's October expectations survey revealed that perceptions of current liquidity had improved since the July survey. In October, 53.1% of respondents considered current liquidity to be high. This proportion was 8.7 percentage points higher than in July. Moreover, as regards liquidity in six months' time, 56.8% of respondents did not expect it to be much different from current levels (Figure 15).

Loan portfolio and credit

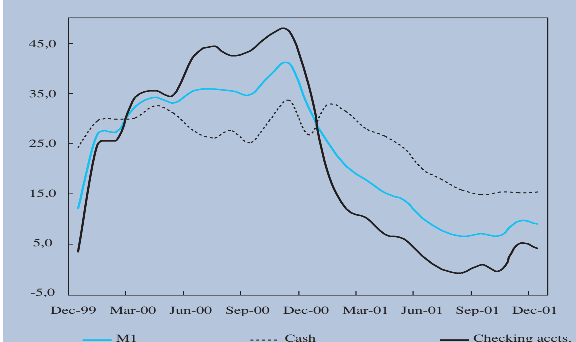
The financial system's loan portfolio improved slowly but steadily all through 2001. By December 2001,

FIGURE 10
TREASURY REPOS AS A PROPORTION OF LIABILITIES SUBJECT TO RESERVE
(PERCENTAGE)



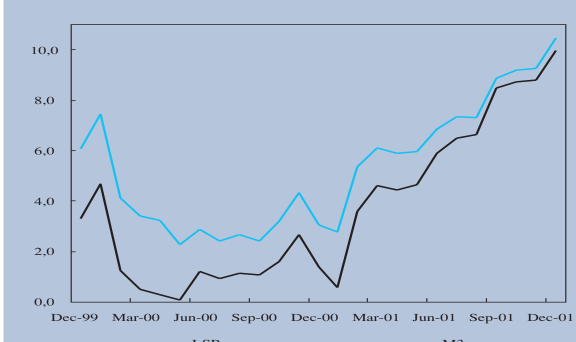
Source: Banco de la República, SGEE.

FIGURE 11
M1 AND ITS COMPONENTS
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



Source: Banco de la República, SGEE.

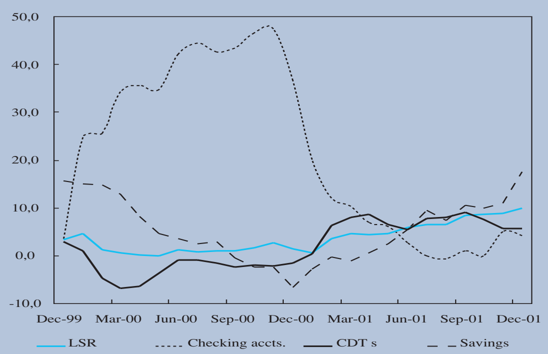
FIGURE 12
M3 AND LIABILITIES SUBJECT TO RESERVE (LSR)
(ANNUAL % CHANGE IN MONTHLY AVERAGE)



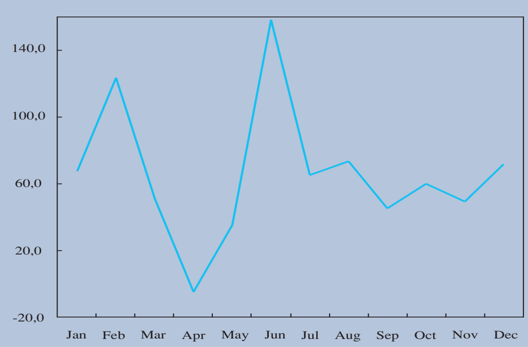
Source: Banco de la República, SGEE.

Figure 13
Liabilities Subject to Reserve (LSR) & its Components
(Annual % Change in Monthly Average)

Components



Treasury Repos, 2001



Source: Banco de la República, SGEE.

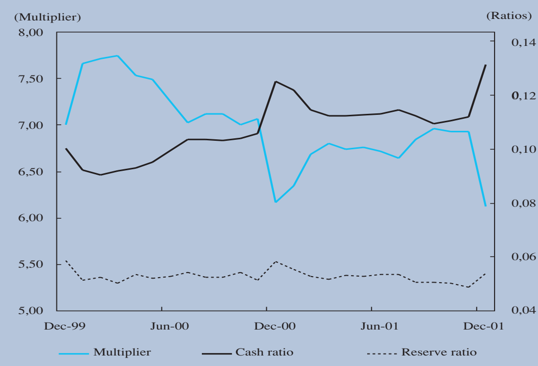
the gross nominal local-currency portfolio of the whole system excluding FEN (National Energy Financing Company) was expanding for the first time since December 1999, at an annual rate of 2.0%, a great improvement on its 7.6% contraction12 months earlier. The portfolio's recovery in the fourth quarter resulted from smaller contraction in the mortgage banks' balance, which made up for slower growth in the rest of the system's balance (Figure 16).

The portfolio's behavior described above is partly attributable to the statistical effect of loan removals from the financial intermediaries' balance sheets[6]. In

---

6 These removals were brought about by the liquidation of a number of financial entities, the writing-down of unproductive assets, reductions by reason of property received in payment, securitization and sale of loans to institutions outside the system, and recalculations of mortgage loans

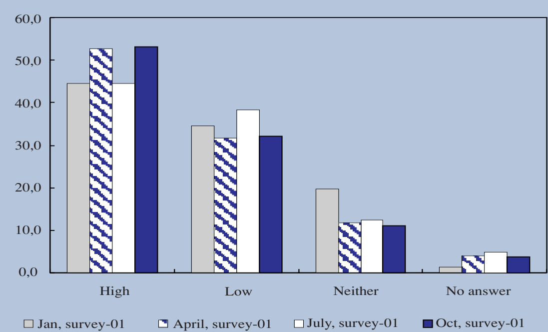
Figure 14
M3 Multiplier



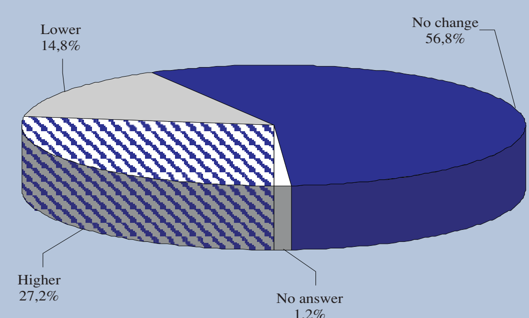
Source: Banco de la República, SGEE.

Figure 15
Liquidity: 2001 Expectations Surveys

(A)
Current Perception of Liquidity



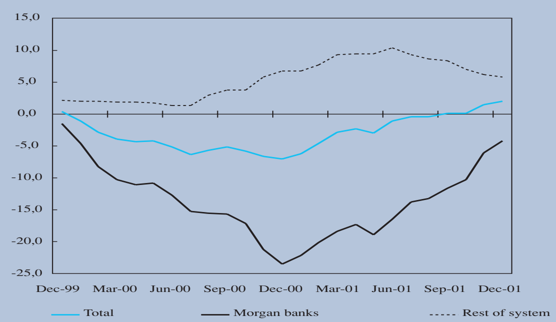
(B)
Perception of Liquidity in 6 Months' Time, October Survey:



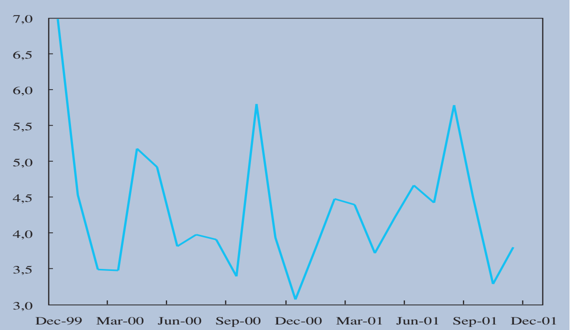
Source: Banco de la República, 2001 Expectations Surveys.

Figure 16
Gross Local-currency Loan Balance of Financial System Excluding Fen

Nominal
(Annual % Change in Monthly Average)



Adjusted (*)
(Annual % Change)



(*) Updated data to November 2001.
Sources: Banco de la República and Banking Superintendency.

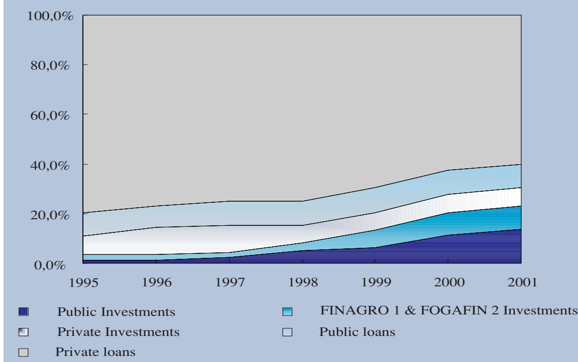
November, the gross nominal portfolio as adjusted[7] for such removals grew at an annual rate of 3.8% (Figure 16).

The portfolio's sluggish growth is not ascribable to poor financial saving, since, as mentioned above, M3 grew at an ever-faster pace all through the year. The increased amounts of funds available to the financial system have been largely channeled to purchasing Treasury paper, as evidenced by the higher share of TES in the sector's financial assets (Figure 17).

Figure 18 shows the overall portfolio's behavior by type of loan (commercial, consumer and mortgage) up to November 2001. Commercial loans, having grown increasingly faster since December 2000, reversed this trend between June and September, while consumer loans have been expanding steadily since March. The mortgage portfolio's rate of contraction has been falling since December 2000. Between September and November, the pace of growth rose significantly in commercial loans (from 3.0% to 4.4%) and more strongly in consumer loans (from 5.8% to10.4%).

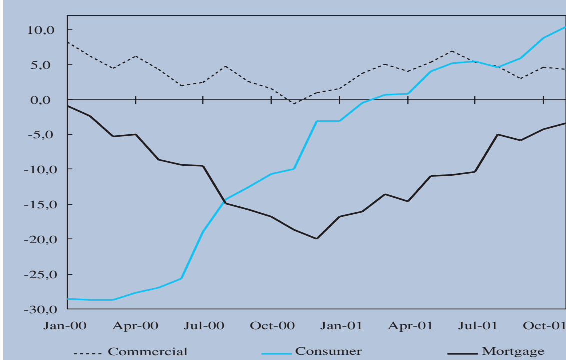
The Bank's October 2001 expectations surveys shows that 46.9% of respondents considered credit availability to be low at the time, and 67.9% expected that in six months' time it would still be low or drop even further (Figure 19).

Figure 17
Financial System's Assets, by Component as Share of Total



Sources: Banco de la República.

Figure 18
Gross Nominal Local-currency Loan Portfolio, by Type of Loan (Annual % Change)

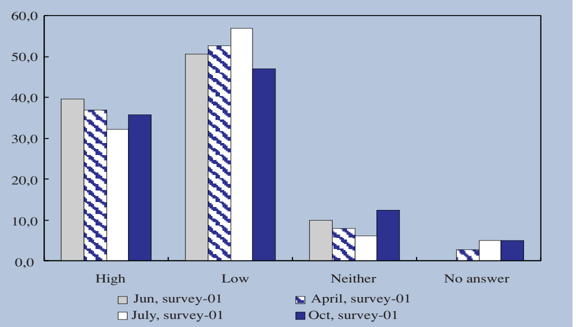


Source: Banco de la República and Banking Superintendency.

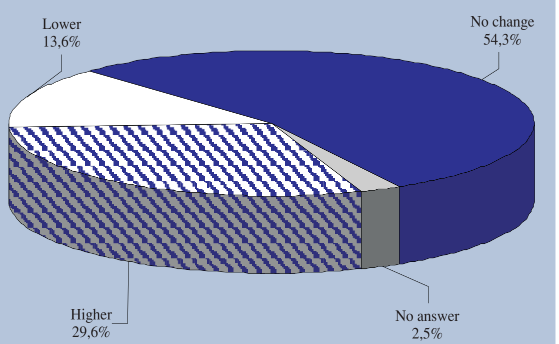
[7] The corrected portfolio is the gross portfolio as it would have been without those loan removals.

Figure 19
Credit Availability: 2001 Expectations Surveys

(A)
Perception of Current Availability

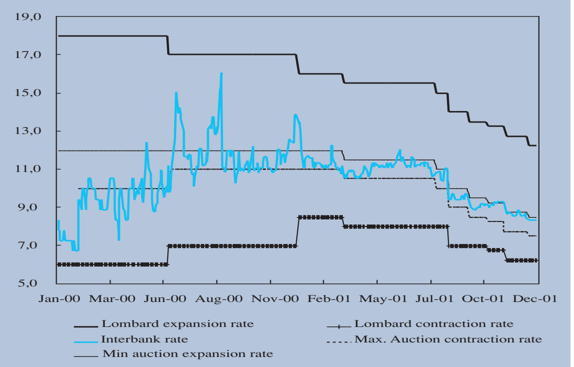


(B)
Perception of Availability in 6 Months' Time, October Survey



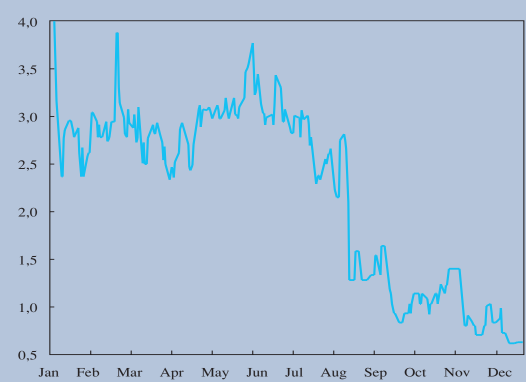
Source: Banco de la República, 2001 Expectations surveys.

Figure 20
Banco de la Repúlica's Interbank and Intervention Rates



Source: Banco de la República.

Figure 21
Real Interbank Rate, 2001
Daily Series



Source: Banco de la República.

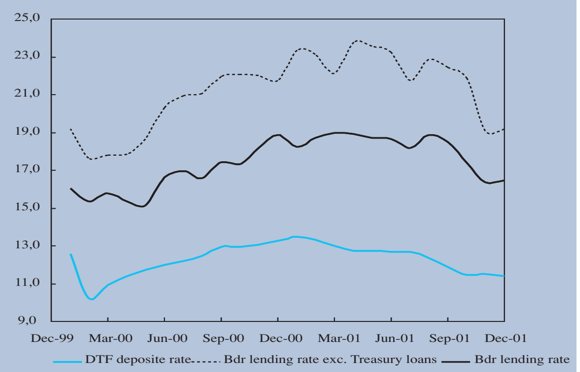
3. Interest rates

The interbank rate continued to fall steadily over the fourth quarter, thanks to several cuts made in the Banco de la República's intervention rates. In December, the interbank rate averaged 8.4%, its lowest level since January 2000, and 0.9 percentage points lower than at the end of September (Figure 20). In real terms, the interbank rate averaged 0.7% in December, while its average for the fourth quarter was 1.0%, the lowest since June 2000 (Figure 21).

The financial system's interest rates also dropped during 2001. The average DTF deposit rate ended the year at 11.4%, down by 0.5 percentage points on three months earlier. The average lending rate, as calculated by the Banco de la República (BdR lending rate), stood at 16.5% in December (2 percentage points lower than in September), while this BdR rate excluding Treasury loans stood at 19.2% (3.3 points lower than in September) (Figure 22). Various factors were at play behind these falls, including an easing of monetary policy by the Bank, lower external interest rates, lower expectations of devaluation and inflation, and little buoyancy in credit because of sluggish economic growth.

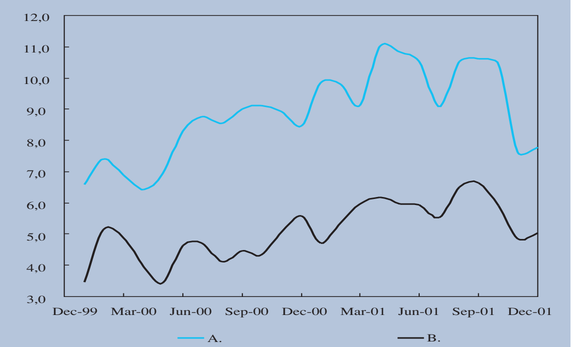
Interest rates for individual types of loans also dropped significantly over the fourth quarter, following the downward trend in deposit rates. Preferential loans showed the biggest September-December rate drop (2.5 percentage points, down to 14.1%), followed by common loans (2.4 points, down to 19.4%) and credit cards (1.3 points, down to 33.3%) (Figure 23).

Figure 22
Nominal Interest Rates
(Effective Annual Rate)



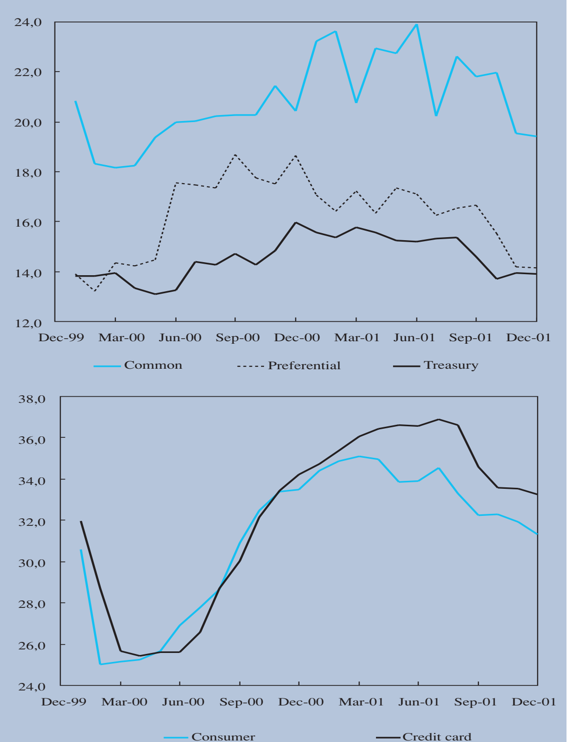
Source: Banco de la República, SGEE.

Figure 24
Interest-rate Differentials



A. Difference between BdR lending rate excluding Treasury loans, and DTF deposit rate.
B. Difference between BdR lending rate and DTF.
Source: Banco de la República.

Figure 23
Nominal Interest Rates,
by Type of Loan



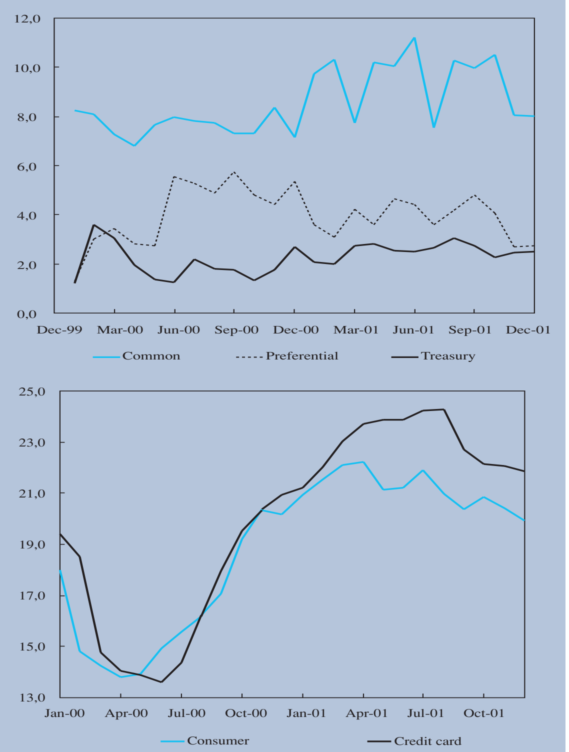
Sources: Banco de la República and Banking Superintendency.

In contrast to what occurred over much of the year, in the fourth quarter the fall in lending rates was significantly bigger than the decrease in the DTF deposit rate. This led to an appreciable narrowing of rate differentials. Thus, in December, the difference between the BdR lending rate and DTF was 5.1%, a narrowing of 1.6 percentage points relative to September. Over the same period, the difference between the BdR lending rate excluding Treasury loans and the deposit rate decreased by 2.8 points to 7.8% (Figure 24). Differentials between the rates of individual types of loans and the DTF deposit rate also narrowed (Figure 25).

Decreases in nominal rates continued to bring down real rates in the fourth quarter. As can be seen from Figures 26 and 27, both deposit and lending rates declined in real terms, as did rates for individual types of loans. In real terms, the deposit rate edged down from 3.6% in September to 3.5% in December, while the BdR lending rate fell by 1.6 percentage points to 8.2%, and the BdR rate excluding Treasury loans dropped by 2.7 points to 10.7%.

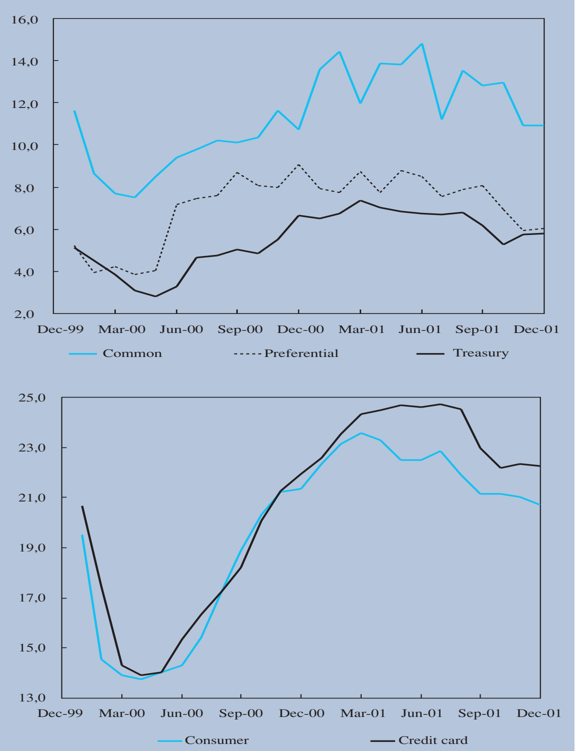
The fourth quarter saw reductions in nominal deposit rates for all maturities. Figure 28 shows how the yield curve for the basic interest rate calculated by the Banking Superintendency (TBS rates) has evolved since December 2000. TBS rates continued to fall during the fourth quarter of 2001, ending the year between 7.7%, for short maturities, and 12.0%, for the longer ones. The slope of the curve

Figure 25
Interest-rate Differentials, by Type of Loan



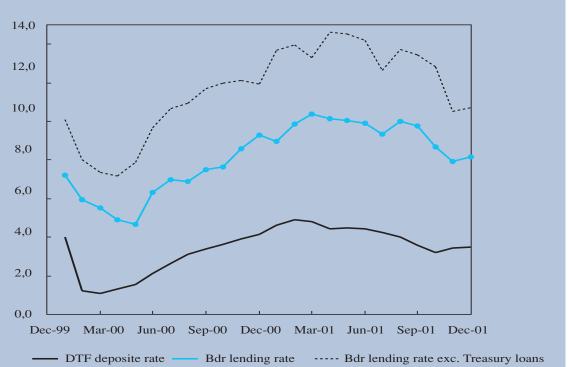
Sources: Banco de la República and Banking Superintendency.

Figure 27
Real Lending Rates, by Type of Loan



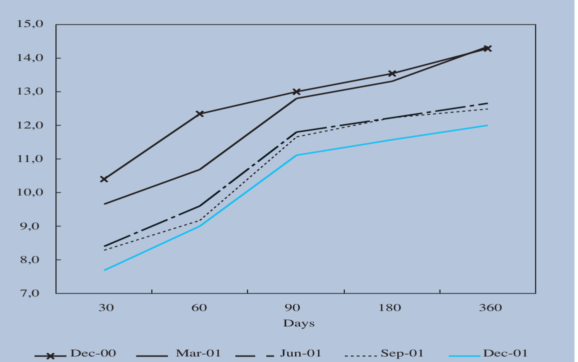
Sources: Banco de la República and Banking Superintendency.

Figure 26
Real Deposit and Lending Rates



Sources: Banco de la República.

Figure 28
Basic Deposit Rate (TBS) for Different Maturities, Calculated by Banking Superintendency

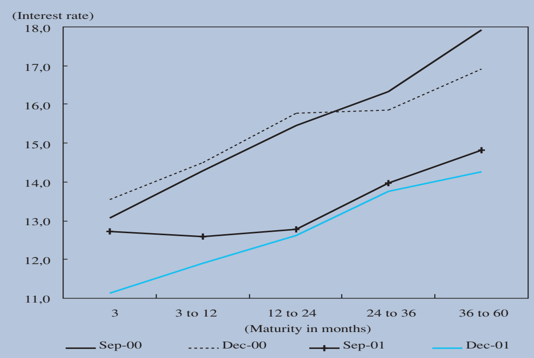


Source: Banking Superintendency.

in December was not much different from what it had been in the previous four quarters, suggesting that the market did not expect any significant pick-ups in TBS rates over the following months.

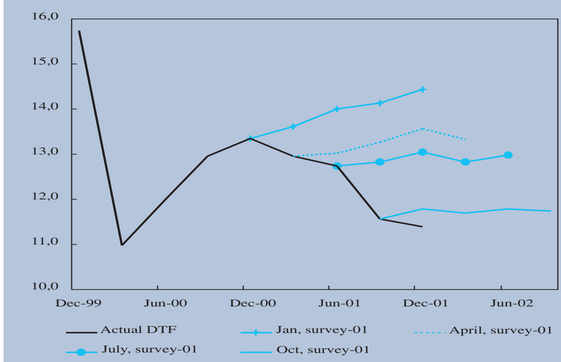
Figure 29 shows the evolution of the yield curve for TES Treasury paper in the secondary market. Although TES yields for all maturities decreased over in 2001, smaller decreases in the longer-term yields

Figure 29
Treasury Yield Curves



Source: Banco de la República.

Figure 30
DTF Deposit-rate Expectations, 2001 Surveys (Effective Annual Rate)



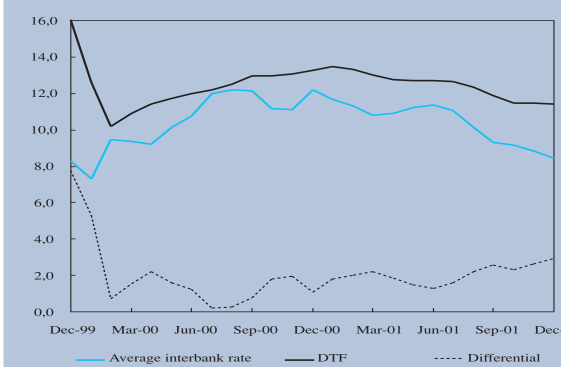
Source: Banco de la República.

meant that the curve retained a relatively steep slope. In December 2001, the biggest drop was in the average yield on three-month securities, which stood 1.6 percentage points lower than in September and 2.4 points lower than a year earlier, whereas interest on five-year securities was 0.6 points lower than in September and 2.6 points lower than in December 2000. A further drop in inflation in the last months of 2001, lower inflation expectations for 2002, and relative exchange-rate stability in the second half of 2001 have set the stage for lower long-term TES yields in the coming months. The yield curve is therefore expected to flatten somewhat in early 2002.

Market expectations favor the above predictions. The Bank's latest quarterly survey, conducted in October, shows, as did the April and July surveys, that interest rates were expected to remain relatively stable over the following quarters. But it is worth noting that the interest-rate drop that actually occurred in 2001 was not anticipated by any of the three surveys. The October survey gave an expected rate of 11.8% for December, which turned out to be 0.4 percentage points higher than the actual rate (Figure 30).

Lastly, Figure 31 shows how the difference between the monthly average interbank rate and the DTF deposit rate rose almost continuously from the beginning of 2001, despite cuts in the Bank's intervention rates. In December, the differential averaged 3.0%. Considering that its historical value is around 200 basis points, there is still scope for further rate reductions in early 2002.

Figure 31
Differential Between 90-day DTF Deposit Rate and Interbank Rate

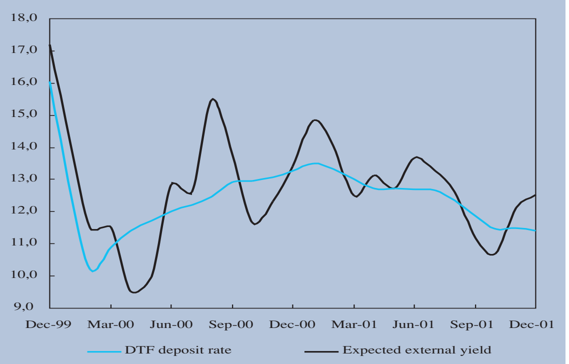


Source: Banco de la República.

4. Yield differentials

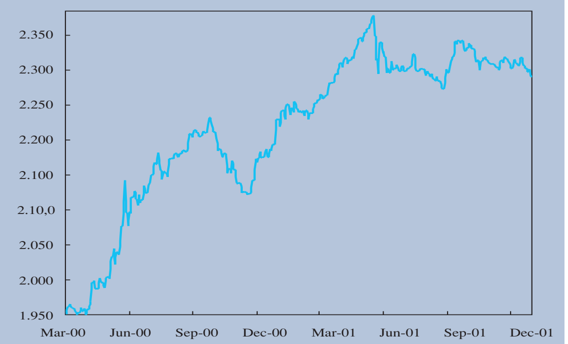
This section deals with the differential between external and domestic yields. External yield is defined as the return that local investors expect to obtain if they decide to invest in dollar-denominated assets. It is estimated on the basis of an external interest rate of reference, and devaluation expectations. The devaluation expectations used for this purpose are those implicitly contained in the financial system's

FIGURE 32
ACTUAL DOMESTIC AND EXPECTED EXTERNAL YIELDS:



Source: Banco de la República.

FIGURE 33
MARKET EXCHANGE RATE
(PESOS TO THE DOLLAR)



Sources: Banco de la República and Banking Superintendency.

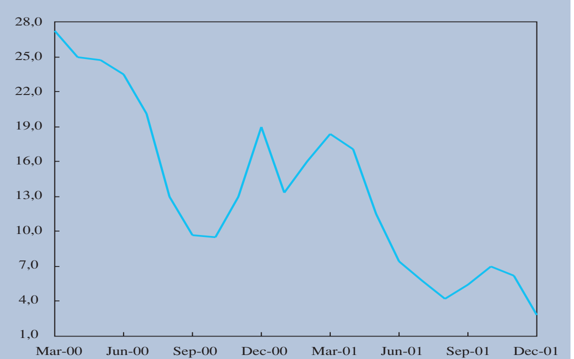
forward (80- to 100-day) dollar sales contracts. The external reference rate is the 90-day CD rate in New York. The DTF deposit rate is used as the domestic rate of reference.

Figure 32 compares expected external yield, and actual yield on domestic investments (as measured by the DTF rate). Over the year, the two stayed reasonably close together but with fluctuations in the expected rate. Thus, in December, expected external yield, at 12.5%, stood 1.4 percentage points higher than in September and 1.1 points above the internal yield. Its rise was largely caused by higher devaluation expectations: in December expected devaluation was 10.8%, 2.6 percentage points higher than in September.

5. Nominal exchange rate

In terms of pesos, the dollar's fate over the first half of the year was mainly determined by Treasury action. Large disbursements under the government's strategy of prefinancing public spending meant that the Treasury held enough liquidity in both pesos and dollars to determine the exchange rate and see that it remained stable. Thus, by the end of December the exchange rate was running at 2,291 pesos to the dollar, with a lower-than-expected annual devaluation of 2.8% (Figures 33 and 34).

FIGURE 34
NOMINAL ANNUAL DEVALUATION RATE



Sources: Banco de la República and Banking Superintendency.

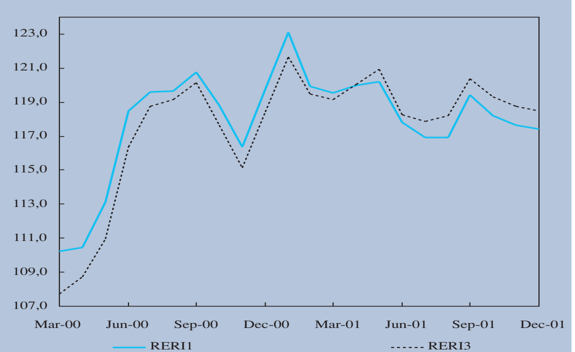
According to the Bank's October expectations survey, the exchange rate in 2002 is predicted to run at 2,424 pesos in March, 2,465 pesos in June, and 2,518 pesos in September, with annual devaluation rates of 4.9%, 7.2% and 8.0% respectively.

6. Real exchange rate

The real exchange rate, as measured by the RERI-1 index (1994 = 100), which is based on Colombia's Producer Price Index and those of its 20 trading partners, averaged 117.4 in December, two points lower than in September (119.4), showing a real revaluation of 1.7% for the quarter and 2.0% for the year. But, using the RERI-3 index (1994 = 100), which is based on Consumer Price Indices, gives a real revaluation of 1.6% for the fourth quarter and zero devaluation for the year (Figures 35 and 36).

The real exchange rate can be disaggregated into two components: an external component and a domestic one, each determined by the respective inflation-devaluation ratios. At the end of 2001, external inflation was slightly lower than external devaluation, pushing the peso towards real devaluation. But, since Colombian inflation was higher than the peso's average devaluation, the domestic component completely neutralized the external component's devaluationary effect, causing the real exchange rate to appreciate.

Figure 35
Real Exchange Rate Indices
RERI-1 and RERI-3 (1994 = 100)



Source: Banco de la República, SGEE.

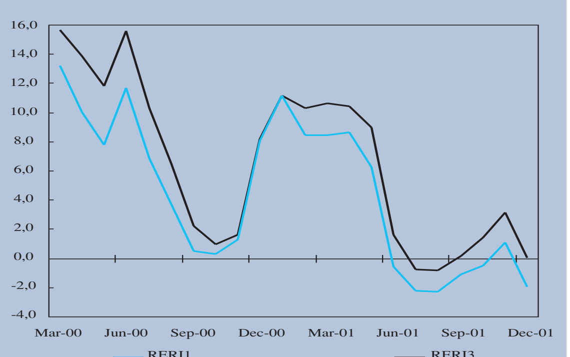
7. Asset prices

A description follows of two variables that indicate the price behavior of certain assets in Colombia. The first is the Colombia Stock Exchange General Index (IGBC), an aggregate measure of price movements in the market's most representative shares, using a basket of shares periodically selected on the basis of their rotation and frequency.

The IGBC index rebounded strongly in the fourth quarter of 2001 from its collapse after the terrorist attacks in the United States, registering an annualized valuation rise of 22.2%, higher than that of any other financial asset. But even so the index is still below the levels it had reached between July and early September. Behind this behavior lie such factors as stability in the fixed-income securities market, low trading volumes, highly volatile share prices, and the separation Bavaria and Valores Bavaria.

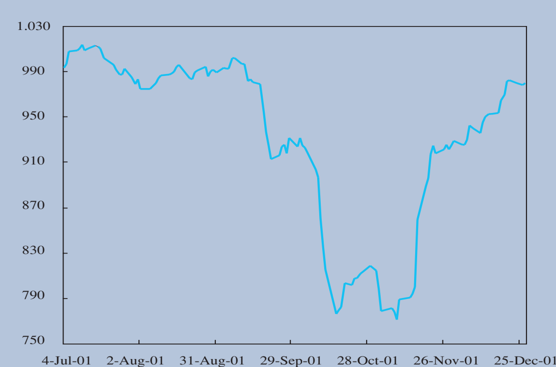
Another asset-price indicator in Colombia is the National Planning Department's housing-price index for Bogotá and Medellín, prepared on a monthly basis since 1994. At the end of November, the last month for which information is available, nominal price increases were still higher in Bogotá than in Medellín.

Figure 36
Real Annual Devaluation Rate
RERI-1 and RERI-3 (1994 = 100)



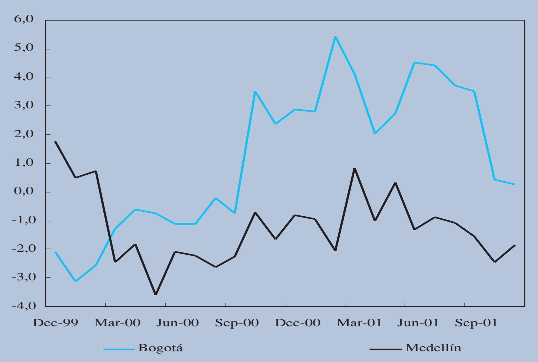
Source: Banco de la República, SGEE.

Figure 37
Colombia Stock Exchange General Index



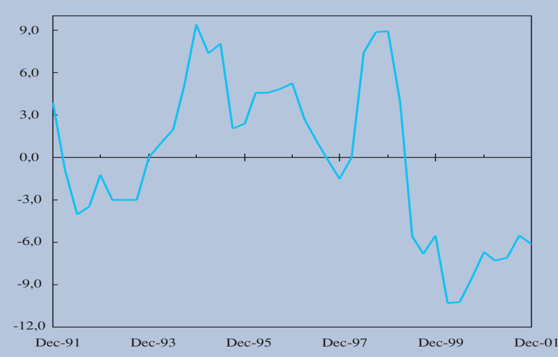
Source: Bogotá Stock Exchanges.

FIGURE 38
HOUSING-PRICE INFLATION IN BOGOTA AND MEDELLIN
(TO NOVEMBER)



Source: National Planning Department (DNP).

FIGURE 39
MONETARY CONDITIONS INDICATOR (MCI)
FOR AGGREGATE DEMAND
(PERCENTAGE)



Source: Banco de la República, SGEE.

In November, housing prices went up in Bogotá by an annual rate of 0.3%, which was 7.5 percentage points lower than annual consumer inflation at the time, but continued to contract in Medellín, the 1.9% contraction rate being 9.7 percentage points lower than consumer inflation.

8. Monetary Conditions Indicator

Movements of the Monetary Policy Indicator (MCI) in 2001 suggest that monetary policy was loose all through the year. The indicator's fourth-quarter level, in particular, was the outcome of lower interest rates and nominal exchange-rate stability (Figure 39).

B. SUPPLY AND DEMAND

1. General considerations

GDP grew more slowly over the third quarter (by an annualized 0.98%) than was forecast by either the previous Inflation Report or most economic analysts. This weakening of the economy in the second half of 2001 makes it highly unlikely for the government's 2.4% growth target to have been met. Everything now points to a growth range of 1.4% and 1.8% in 2001.

Poor annual growth rates notwithstanding, the seasonally adjusted quarterly series shows that the economy grew faster in the third quarter than in the previous two. This fact and the results of some leading indicators (discussed below) point to a possible improvement in growth over the fourth quarter.

Prospects for the first quarter of 2002 are less clear. On the one hand, there are signs of a slight pick-up in internal demand. And, according to DANE's data to October, nontraditional exports appear to have regained the ground lost in the wake of the September-11 events. Furthermore, the fact that the inflation target has been met should bring stability to the exchange market and interest rates. But, on the other hand, the threat of a huge devaluation in Venezuela and its implications for Colombia, a late, slow recovery of the US economy (officially in recession), and low world prices for oil and coffee may hinder Colombia's economy from improving in 2002. The Argentine crisis, though, is not expected to affect it in the first half of 2002.

2. Third quarter of 2001

The third quarter's low annual GDP growth was caused exclusively by contraction of industrial and farm production relative to a year earlier. In all other sectors, except commerce, output not only expanded but did so at a faster pace (Table 9).

The biggest contribution to third-quarter growth came from the sector of social, community and personal services, boosted by government services, thanks in part to reduction of the budget lag (payment arrears and budget reserves) and faster execution of budget spending. The mining and quarrying sector was the second biggest contributor as a result of a 33.1% surge in coal production and recovery of oil production from the Caño Limón field. Lastly, the construction sector, with a rise mostly in buildings, also gave a strong thrust to growth.

Regarding the decline in manufacturing, it is to be noted that 14 of the 19 subsectors contracted, apparently because of a fall in external demand, a reduction in orders (especially from exporting

Table 9
Quarterly GDP, by Sector:
Seasonally Adjusted Series
(Annual Percentage Change)

Sector	2000 (p)					2001 (p)		
	I	II	III	IV	Full year	I	II	III
Farming, forestry, hunting & fishing	1,17	7,28	4,21	8,23	5,18	3,17	(0,37)	(0,27)
Untoasted, undecafeinated coffee	(16,84)	29,61	(8,72)	35,40	6,92	20,14	(11,81)	6,07
Livestock and animal products	4,43	0,61	4,17	1,31	2,61	(1,95)	(2,19)	(4,06)
Forestry products and logging	1,96	4,85	1,05	0,56	2,09	0,60	(5,02)	(1,31)
Mining and quarrying	(0,99)	(7,54)	(7,51)	(5,75)	(5,45)	(7,58)	(3,72)	3,52
Electricity, gas and & water	4,59	1,98	0,92	1,79	2,30	1,07	3,00	2,83
Manufacturing	8,54	11,03	12,88	7,19	9,88	2,75	1,26	(3,31)
Meat and fish	8,00	0,89	7,83	2,04	4,61	(2,16)	(5,49)	(9,23)
Tobacco products	7,59	5,32	32,09	25,09	17,30	15,97	10,09	(9,82)
Garments	31,18	22,08	11,15	(0,96)	14,73	1,30	(3,15)	(13,69)
Paper and cardboard	18,91	24,63	27,96	19,57	22,75	12,96	2,80	(11,28)
Chemicals	7,78	14,69	15,89	9,77	11,98	0,46	(5,45)	(12,68)
PMetal products excl. machinery	28,47	13,72	17,11	7,01	16,09	1,80	(2,13)	(12,81)
Construction	(7,58)	(0,98)	(0,57)	5,60	(1,06)	(4,27)	(1,42)	3,90
Construction work & buildings	(15,55)	(6,70)	4,98	7,16	(3,04)	7,14	9,66	7,85
Civil-engineering work & projects	(0,68)	3,77	(4,98)	4,35	0,58	(12,66)	(9,69)	0,43
Commerce, repairs, restaurants & hotels	2,33	5,85	6,66	5,40	5,06	4,20	1,83	0,45
Transport, warehousing & communications	3,44	3,76	3,97	3,27	3,61	2,05	2,54	2,46
Financial, insurance and real-estate firms	(1,56)	(0,01)	1,11	(0,58)	(0,26)	1,22	0,10	1,19
Social, community & personal services	0,53	(1,91)	(1,08)	(1,70)	(1,05)	(0,24)	0,79	1,66
Market social & health services	1,47	1,80	1,95	1,96	1,80	1,96	1,75	2,33
Association and recreation services & other market services	(10,06)	(8,48)	(1,83)	(4,34)	(6,27)	(0,10)	3,06	2,34
Government services	1,40	(2,08)	(1,63)	(2,21)	(1,15)	(0,70)	0,39	1,58
Gross Domestic Product	1,82	3,10	3,39	2,95	2,81	1,72	1,64	0,98

(p) Provisional.
Source: DANE.

Table 10
Demand View of GDP Growth
(Annual % Change)

	2000 (p)					2001 (p)		
	I	II	III	IV	Full year	I	II	III
Gross domestic product	1,82	3,10	3,39	2,95	2,81	1,72	1,64	0,98
Total imports	3,65	6,60	8,80	3,89	5,70	10,91	21,02	13,47
Total final supply	2,09	3,60	4,17	3,09	3,20	3,10	4,49	2,86
Final consumption	1,81	1,19	1,04	0,13	1,00	1,31	1,30	1,00
Households	1,95	2,38	2,72	1,69	2,60	2,02	1,62	0,55
Nondurables	2,35	1,34	2,28	(0,28)	1,40	0,29	(0,63)	(3,92)
Semidurables	4,17	7,66	8,51	10,53	7,50	6,53	6,37	6,01
Services	0,51	1,49	2,22	1,53	1,40	2,51	2,66	2,99
Durables	11,95	14,41	6,82	7,51	10,00	7,41	4,39	5,85
Government	1,40	(2,08)	(3,55)	(4,12)	(2,00)	(0,70)	0,39	2,31
Gross capital formation	1,18	21,80	24,21	15,04	14,90	8,80	15,76	8,42
Gross fixed capital formation	(11,00)	(1,11)	3,74	9,17	(0,20)	4,19	11,04	10,81
Machinery & equipment	(15,16)	(4,79)	13,69	18,41	1,90	17,42	36,20	19,22
Transport equipment	(5,75)	10,14	3,79	0,15	1,90	30,73	33,07	43,27
Buildings	(21,03)	(7,42)	7,86	11,17	(3,50)	7,29	10,18	7,95
Civil works	(0,56)	3,79	(4,98)	4,21	0,60	(12,70)	(9,69)	0,49
Subtotal: final domestic demand	1,72	3,67	3,89	2,03	2,80	2,37	3,34	2,09
Total exports	4,13	3,23	5,65	8,71	5,50	6,96	10,56	6,84
Total final demand	2,09	3,60	4,17	3,09	3,20	3,10	4,49	2,86

(p) Provisional
Source: DANE.

companies), negative expectations about the economies of Colombia's main trading partners (including Venezuela), and perhaps a policy of destocking.

On the side of demand (Table 10), exports continued to drive growth in the third quarter, as they had been doing for over a year, but their rate of annual expansion (6.8%) was significantly lower than in the second quarter, partly because of weakening US demand, made worse by events in September.

Growth in domestic demand continued to be low (2.1%), owing to feeble expansion in final consumption (1.0%). In comparison, expansion in gross capital formation was considerably stronger (8.4%), as in the previous quarters.

Investment spending rose more slowly in the third quarter than in the second. The main reason was faster deceleration of spending on machinery and equipment and on buildings than acceleration of spending on civil works and transport equipment. But it is not surprising that investment grew more slowly, given its very strong expansion the year before.

Final consumption also slowed over the third quarter, especially in the case of households. In contrast, public consumption increased, probably because of partial reduction of the budget lag and retroactive salary adjustments.

Slower annual growth in household consumption resulted exclusively from shrinking consumption of nondurables, specifically food and beverages. As stated in previous Reports, nondurables consumption has been decelerating significantly since the end of 2000, in contrast with good growth in other components of household consumption, particularly durables and semidurables, and with imports of consumer nondurables-data to October give a13.6% annual growth (Figures 40 and 41).

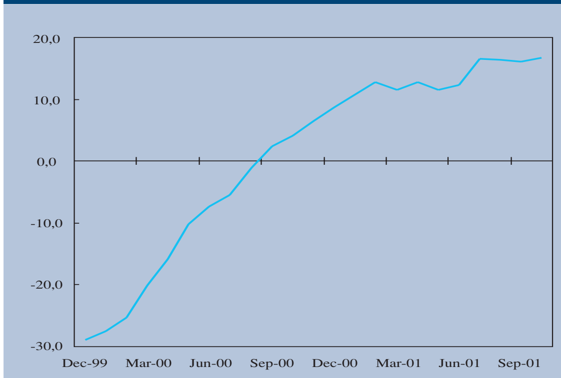
Although domestic demand lost pace, the trade balance surplus disappeared over the second and third quarters, as GDP growth was outpaced by growth in domestic spending and the resultant gap had to be closed through a higher supply of imports. This was in sharp contrast to the situation obtaining in the previous two years, when domestic production was sufficient to meet domestic and external demand, resulting in a trade surplus (Figure 42).

3. Fourth quarter of 2001 and first quarter of 2002

The latest data suggest that the economy may have grown faster in the fourth quarter than in the third. Growth in construction, commerce, farming, mining and quarrying, and personal and community services can now be expected to have been stronger than in the third quarter. And, although manufacturing is not reckoned to have actually expanded, it may have registered a trend break, judging from the findings of Fedesarrollo's Business Opinion Survey.

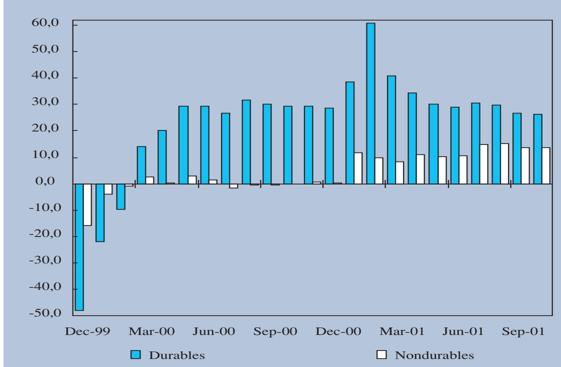
Improvement in the construction sector is expected to have been mostly in construction work and buildings. The latest data on the sector show it to have regained considerable strength in recent months, with all that this implies in terms of new jobs, especially for unskilled labor. Specifically, there was a sharp rise in building licenses in November (Figure 43). Similarly, loans to home builders and buyers also expanded strongly (Figure 44). Lastly,

Figure 40
Overall Consumer-goods Imports, to October 2001
(Annual % Change in 12-month Accumulated)



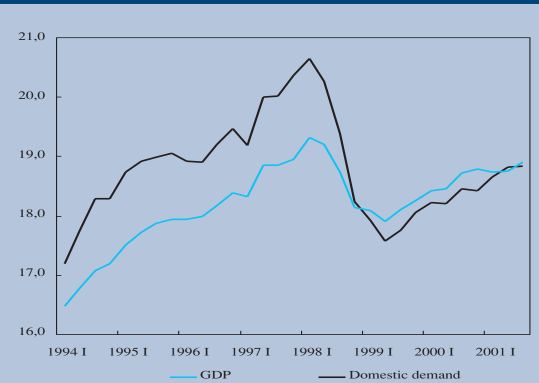
Source: DANE.

Figure 41
Durable & Nondurable Consumer Imports, to October 2001
(Annual % Change In 12-month Accumulated)



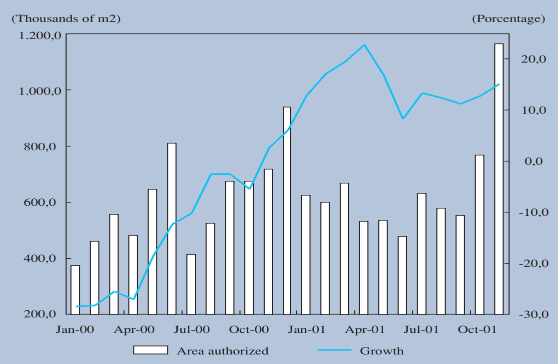
Source: DANE.

Figure 42
GDP and Domestic Demand, Seasonally Adjusted Series
(Billions of 1994 Pesos)



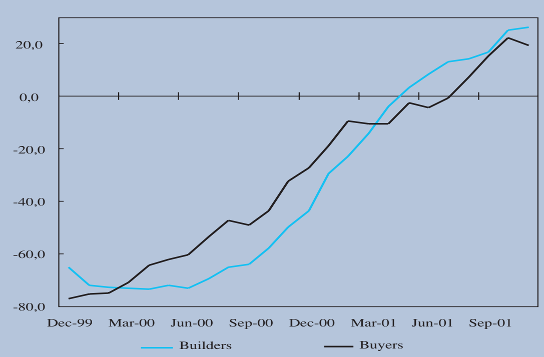
Source: DANE.

Figure 43
Building Licenses Growth in Past 12 Months



Source: DANE.

Figure 44
Housing Loans to Builders & Buyers
(Percentage Change in Past 12 Months)

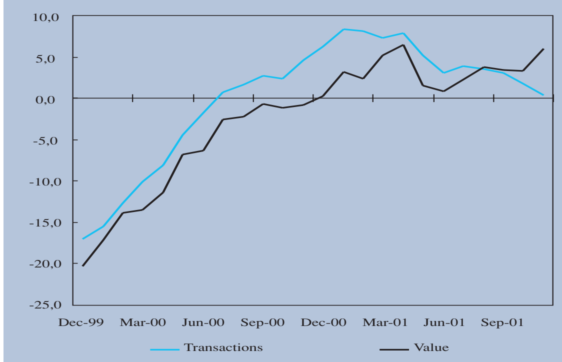


Source: ICAV (association of building & loan entities).

information on real-estate transactions from Fedelonjas (realtors' association) shows that, although the total number of transactions in nine cities has decreased over the past 12 months, their value has increased (Figure 45).

According to DANE's Monthly Sample, the retail trade saw actual sales excluding fuel grow by an acceptable annual rate of 4.6% in real terms in October, a somewhat higher rate than the third-quarter average. From January to October, actual sales rose in real terms in 14 out of the 16 groups of merchandise, notably in the group of office equipment (33.0%).

Figure 45
Real-estate Transactions, by Number & Value
(Percentage Change In Past 12 Months)



Source: Fedelonjas.

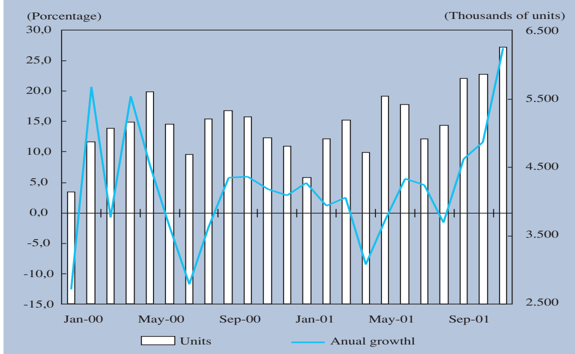
The number of new vehicles sold in Colombia in November was 6,251, an annualized growth of 27.1%, which confirms buoyancy in this group (Figure 46). This information is particularly interesting for two reasons. First, it points to the start of a new cycle of durable consumer goods replacement, which may give demand a boost in the coming months. Second, it implies that consumers are once again counting on the financial system and thus showing higher expectations about future income.

Electricity consumption is another reason for expecting urban economic activity to recover, or at least not to weaken further. In the fourth quarter, monthly growth in power consumption averaged 2.5 %, slightly lower than in the third but higher than in the first half of the year (Figure 47).

According to DANE, monthly manufacturing output contracted in October (by 1.1%) for the third month in a row. In November, however, the findings of Fedesarrollo's Business Opinion Survey pointed to a possible reversal of this trend, indicating distinct falls in inventories for both export and non-exporting companies (Figure 48), and a continued pick-up in orders for exporting firms, while non-exporters maintained an acceptable level of orders (Figure 49).

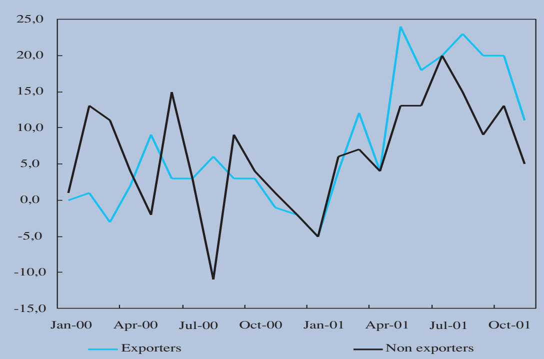
It should be noted that figures to October presented by ANDI (a major business association) indicate a

Figure 46
Monthly Vehicle Sales, Excluding Exports



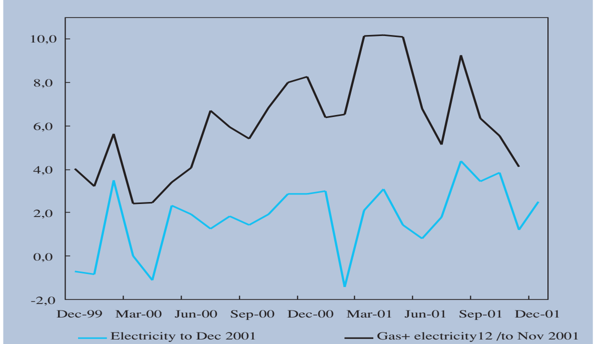
Source: SGEE on data from General Motors Colmotores.

Figure 49
Manufacturers' Current Order Volumes (Balances - to November 2001)



Source: Fedesarrollo.

Figure 47
Electricity And Gas+Electricity Consumption (Annual % Change In Monthly Consumption)



Sources: ISA (major power transmission company) and Ecopetrol (state oil company).

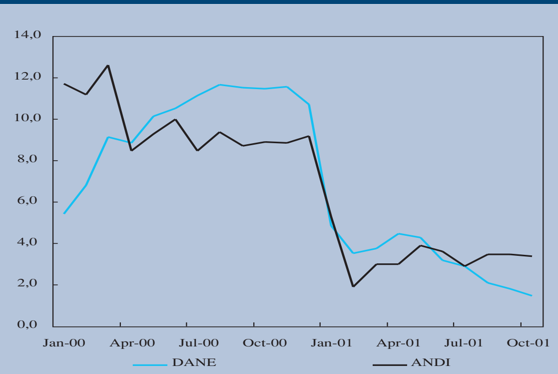
Figure 48
Manufacturers' Current Stock Levels (Balances, to November 2001)

Source: Fedesarrollo's Business Opinion Survey.

slower deceleration in industrial output than is indicated by DANE's figures. According to ANDI, in October industrial production registered a January-to-date growth rate of 3.4%, very similar to the 3.5% average for the second quarter and the 3.3% average for the third. In contrast, DANE's Monthly Manufacturing Sample for October gave a January-to-date growth of 1.5% in industrial output, lower than the Sample's 4.0% average for the second quarter and 2.3% average for the third (Figure 50). Data from both organizations indicate strong expansion in transport equipment, earthenware, non-ferrous metals, and petroleum byproducts.

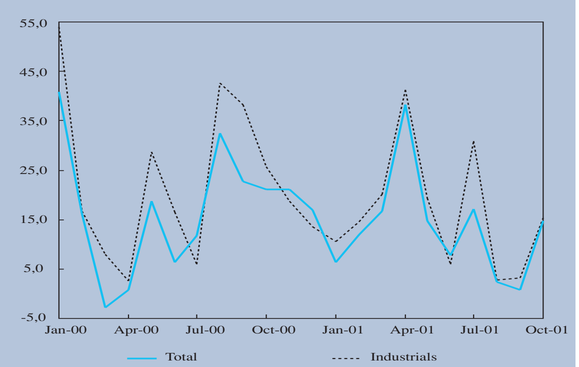
Expected higher growth in the fourth quarter could have come from both satisfactory external demand and faster expansion of domestic demand. In effect, DANE's figures show a 1.9% upturn in total exports in October over the same month in 2000, largely driven by a 14.7% annual rise in nontraditionals, in a new repetition of the growth pattern nontraditionals had displayed earlier in the year (Figure 51).
The events of September 11 had a transitory effect on nontraditional exports to the United States: they fell sharply in September because of the paralysis of air freight but picked up again in October (by 1.9%) relative to the same month a year earlier (Figure 52). Nontraditional exports to Colombia's other two major trading partners, Ecuador and Venezuela, continued to expand at a healthy pace (Figures 53 and 54).

Figure 50
Real Industrial Production Index,
(Annual % Change, January to Date)



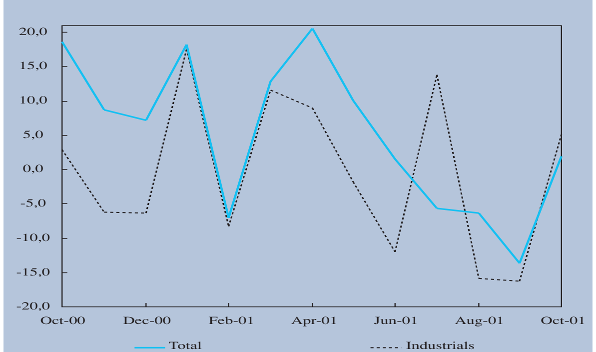
Sources: DANE and ANDI (major business association).

Figure 51
Monthly Nontraditional Exports
(Annual % Change In 12-month Accumulated)



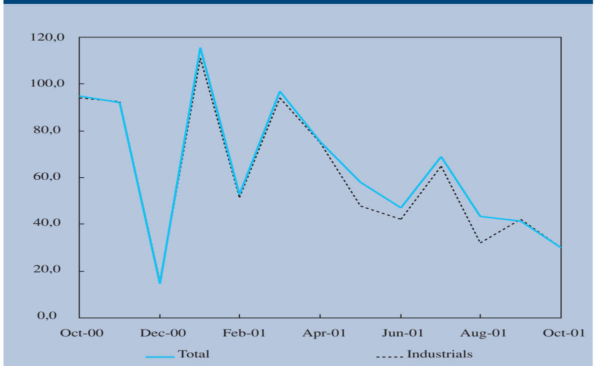
Source: DANE.

Figure 52
Monthly Nontraditional Exports to Usa
(Annual % Change)



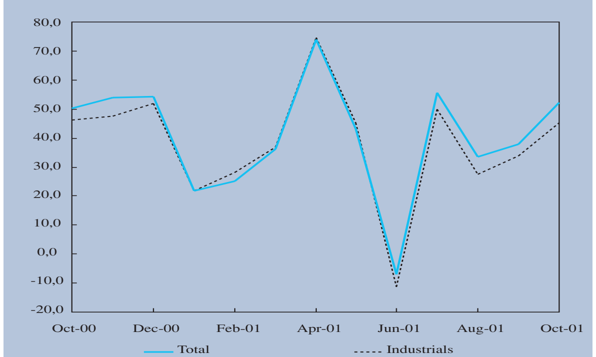
Source: DANE.

Figure 53
Monthly Nontraditional Exports to Ecuador
(Annual % Growth.)



Source: DANE.

Figure 54
Monthly Nontraditional Exports to Venezuela
(Annual % Change)



Source: DANE.

Growth in nontraditional exports over the fourth quarter is expected to have shown the same buoyancy as in the previous part of the year. This expectation is based on DANE's figures to October and also on the Business Opinion Survey 's satisfactory findings in November about exporting firms.

As regards domestic demand, both consumption and investment may have grown faster toward the end of the year. In the case of consumption this is suggested by October's increases in durable and nondurable consumer sales and imports, faster cash expansion in the fourth quarter than envisaged by the Bank's reference line, and rising consumer loans[8]. Similarly, some leading indicators of investment spending, such as procurement of office furniture and equipment, capital-goods imports (excluding those for Plan Colombia and the Transmilenio massive transport system), and domestic production of capital goods, point to continued investment growth at the end of the year.

Lastly, public consumption and investment in the fourth quarter of 2001 may have received a boost from early payment of year-end bonuses to public employees, retroactive salary adjustments ordered by the Constitutional Court, and higher execution of spending in general.

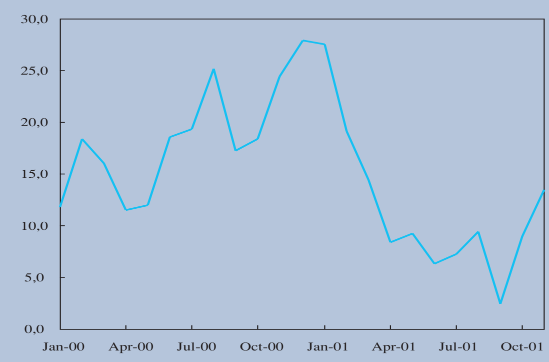
Economic performance in 2002 will benefit from a number of existing factors, such as low interest rates, a long cycle of durable-goods consumption, and ample liquidity. In addition, there are good expectations of higher construction growth and lower unemployment. Much the same may be said about manufacturing, given November's sharp rise in the business-climate indicator, which is a combined measure of business opinion about the economy's current status and its prospects for six months ahead (Figure 55).

There are however other, persisting, factors that threaten economic performance on the external and domestic fronts. Externally, low prices are expected for the country's main export products, particularly coffee, and to some extent, oil. In addition, our major trading partners are expected to suffer further economic downturns in 2002. Venezuela's economic growth is forecast to be much slower than in 2001 because of greater exchange-rate instability, low oil prices, and political unrest (see Chapter III: International Context). Ecuador's growth, too, will be affected by low oil prices. And it is uncertain when and how strongly the US economy will be recovering.

Internally, the government's financial plan calls for reductions, in real terms, of operating and investment expenditures. Such reductions will be conducive to growth in the long run by lowering the fiscal deficit but may affect domestic demand in the short run. Domestic demand may be further affected by present uncertainty about the future of the peace process.

8 For details on cash and consumer-loan indicators, see Chapter II, Section A on Monetary Aggregates.

FIGURE 55
BUSINESS CLIMATE
(TO NOVEMBER 2001)



Source: Fedesarrollo.

C. WAGES AND EMPLOYMENT

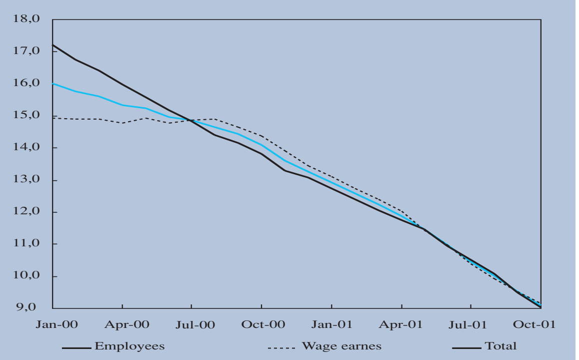
1. Industrial pay

Nominal industrial pay rises continued to decrease up to October 2001. In the 12 months to October, they averaged 9.1% a year for all workers, down from 14.1% in October 2000 (Figure 56). This five-percentage-point fall was much bigger than the drop in inflation over the same period, with the result that pay rises also declined strongly in real terms.

Benefits paid to industrial workers also continued to rise more slowly, averaging 6.8% a year in the 12 months to October, down from 9.3% in October 2000 (Figure 57). Thus, total remuneration (pay plus benefits) rose by rates more in line with inflation, such rates averaging 8.1% a year in the 12 months to October, down from 9.5% three months earlier and 12.0% in October 2000.

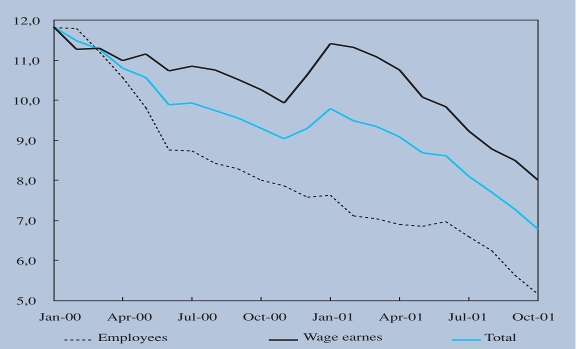
In October, as in the previous months, benefits increases were smaller for employees (5.2%) than

Figure 56
Nominal Industrial Pay
(Average Annual % Change In Past 12-months)



Source: DANE.

Figure 57
Nominal Industrial Benefits
(Average Annual % Change In Past 12-months)

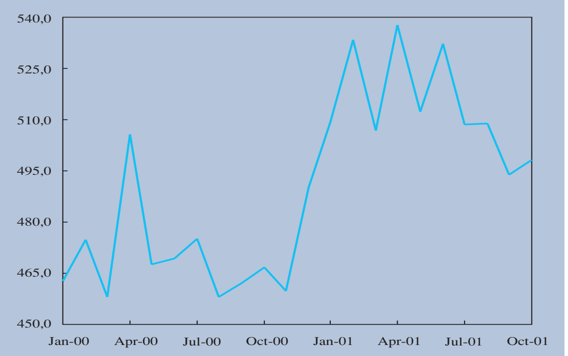


Source: DANE.

for wage earners (8.0%). One reason why wage earners have been more successful than employees in conserving higher benefits increases may be that they are more unionized. Another explanation may be that hiring regulations are different for the two groups and prohibit the hiring of wage earners under “service contracts.”

Over the year, smaller industrial-pay rises and a slight increase in the sector’s productivity brought down labor costs per unit of output. In effect, nominal unit labor costs were 6.4% lower in October 2001 than in June. The indicator’s continuous fall since June was in contrast to its growth trends since late 2000 and remo-

Figure 58
Nominal Unit Labor Cost:
Industrial Wage Earners



Source: DANE.

ved the danger of any inflationary pressures arising from labor costs over the following months (Figure 58).

2. Employment

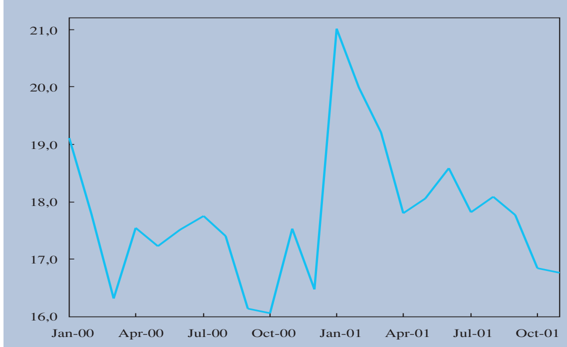
Unemployment for the 13 major cities was 16.8% in November, 0.8 percentage points lower than 12 months earlier (Figure 59). For the country as a whole, the jobless rate was 13.6%, the lowest in 2001. The drop in unemployment came both from higher labor demand (the employment rate was 53.8% in November, 0.3 percentage points up on a year earlier) and from lower labor supply (the global participation rate was 64.6%, down by 0.2 points on November 2000).

Employment for the 13 major cities, as measured by DANE’s Continuous Household Survey, rose faster from August on, reversing the trend it had shown since the second quarter (Figure 60).

Unemployment fell in November despite a further contraction in industrial employment as shown by DANE’s Monthly Manufacturing Sample figures (Figure 61). Higher employment in November must therefore have been closely connected with expanding activity in construction, commerce and services in general.

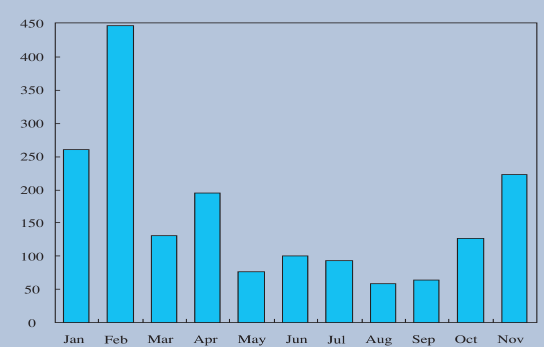
Employment indicators may have continued to improve to the end of the year, given the expected

Figure 59
Unemployment Rate for 13 Major Cities
(New Methodology)



Source: DANE.

Figure 60
Job Creation in 13 Major Cities, 2001
Annual Change in No. of Jobs
(Thousands)

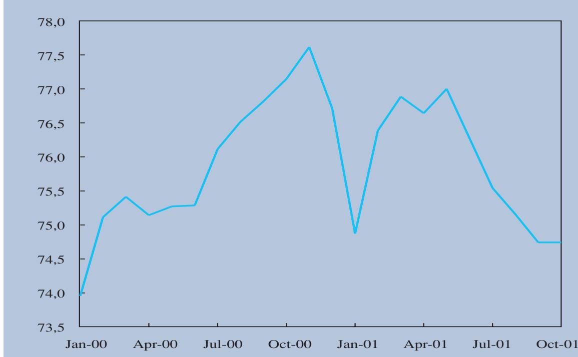


Source: DANE.

rise in economic growth relative to the third quarter. And their improvement could continue over 2002, since construction, a highly labor-intensive activity, is expected to expand.

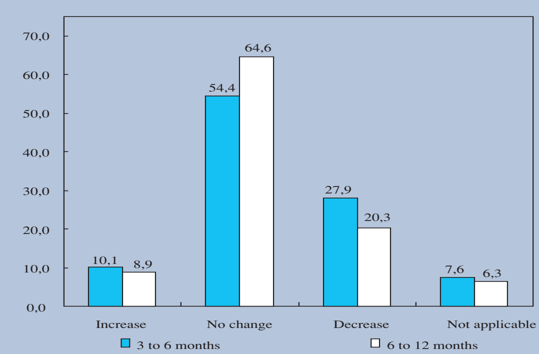
The findings of the Bank's October expectations survey, however, are less optimistic, reflecting a high degree of uncertainty still among the business community about the economy's future (Figure 62). Some 27.9% of respondents were planning to reduce their workforce within three to six months (up from 18.5% in the July survey). Similarly, another 20.3% planned to do so in 6-2 months' time (up from 16.3% in July).

Figure 61
Overall Industrial Employment Index
(Employees + Wage Earners)



Source: DANE.

Figure 62
Corporate Workforce Plans, Short and Medium Term
(Percentage)



Source: Banco de la República, October 2001 Expectations Survey.

3. Pay settlements

The minimum legal wage has been raised by 8.0% for 2002. This increase is two percentage points higher than expected inflation for the year and 0.4 points higher than actual inflation in 2001. But since it is substantially lower than last year's 10.0% rise, it may reduce inflationary pressures from labor costs.

Table 11 presents figures from the Ministry of Labor and Social Security on one- and two-year pay settlements through collective bargaining.

The upper part of Table 11 shows, by pay-rise level, the percentages of workers from public- and private-

Table 11
Pay Settlements: January-December 2001
% of Beneficiaries By Pay-rise Level

One-year rises

<8,75	8,75	[8,8-11,0]	>11,0
9,1	25,4	58,1	7,4

Two-year rises

<10,0	[10,0-15,0]	CPI	[CPI + 0,2-CPI + 2,5]	MLW	Other
14,0	4,1	32,6	42,5	2,0	4,9

MLW: Minimum legal wage.
Source: Ministry of Labor and Social Security.

sector companies covered by one-year pay settlements negotiated between January and December 2001. By the end of the year, 58.1% of these workers had obtained one-year rises in the range of 8.8% to 11.0%, a slightly lower proportion than in September (60.9%). For another 25,4%, the increase was still 8.75%, while those receiving less than 8.75% made up a higher proportion than in September, as did so those receiving over 11.0%.

The bottom part of Table 11 shows, by pay-rise level, the percentages of workers receiving two-year pay increases negotiated between January and December 2001. As can be seen, two-year wage increases ranged between CPI+0.2 and CPI+2.5 for the largest proportion of workers (42.5%, down from 44.9% in September). The proportion receiving a two-year rise equal to CPI dropped from 33.7% in September to 32.6% in December. And only 2.0% settled for a two-year increase equal to the rise in the minimum legal wage.

A higher concentration of workers with one- and two-year pay increases far above actual inflation could mean greater inflationary pressures in 2002 from higher labor costs. This is surprising, considering that inflation has fallen and unemployment remains high.

The Bank's October expectations survey indicates a lowering of expected pay increases for 2002: from 8.7% reported in the July survey, to 8.1% in October. Figure 63 shows clearly how the expected rate was systematically revised down in the course of the year.

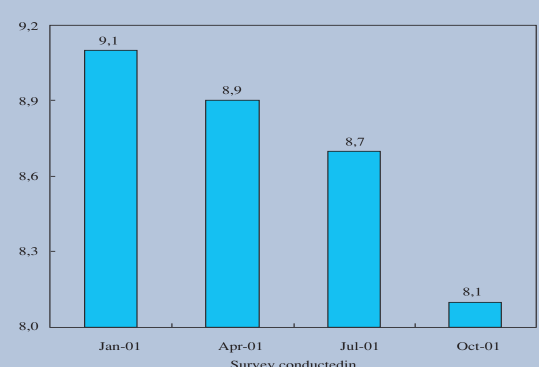
D. Capacity Utilization

Capacity utilization decreased over the three months ending in November relative to the same period in 2000, according to both indicators used for these Reports. Specifically, ANDI's indicator shows an average capacity utilization of 73.3% for September and October, 2.1 percentage points lower than the average for the same months in 2000, while Fedesarrollo's figure for September and November is 68.3%, down by 2.9 points on a year earlier (Figure 64).

Lower capacity utilization resulted from slower industrial production. But it may also have been caused by an increase in installed capacity, to judge from a substantial growth in investment.

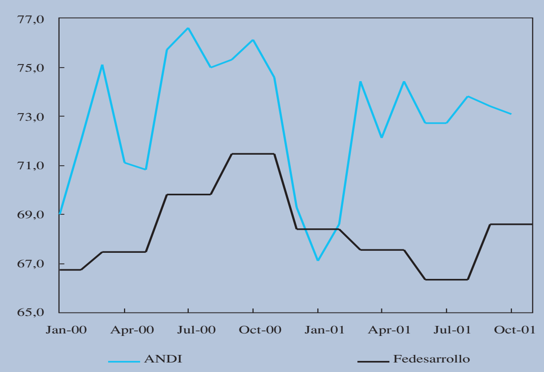
The output gap projected by the transmission-mechanism model points to the existence of ample unused capacity in the economy as a whole. With growth slightly higher in the fourth-quarter than in the third, the output gap would be 2.6% of GDP (Figure 65).

Figure 63
Expected Average Pay Rises in 2002
(Percentage)



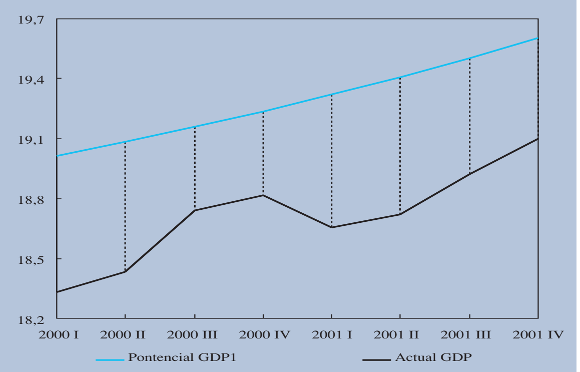
Source: Banco de la República, 2001 Expectations Surveys.

Figure 64
Capacity Utilization
(Percentage)



Sources: ANDI and Fedesarrollo.

Figure 65
Output Gap:
Potential GDP / Actual GDP
(Billions of 1994 Pesos)



Sources: Banco de la República, transmission-mechanism model.

No inflationary pressure is therefore expected from demand in 2002, at least as far as industrial goods are concerned.

E. Fiscal Policy

Results for 2001

The consolidated public-sector deficit amounted to 6,124 billion pesos at the end of 2001, representing 3.3% of annual GDP. The fiscal situation was thus much the same as at the end of 2000, despite a smaller surplus for the decentralized sector and an increase in the cost of restructuring the financial sector (Table 12). But the government's objective at the start of the year had been to reduce the consolidated deficit to 2.9% of GDP. Inability to meet this original objective was caused by both the economic downturn, which affected tax receipts, and by increases in some expenditure items, and led to the fiscal target being revised in the second half of the year.

The decentralized sector's surplus decreased because of lower surpluses reported by Ecopetrol, the Oil Stabilization Fund (FAEP) and the social-security sector. In the case of Ecopetrol, the fiscal drop came largely from falling external crude prices and lower oil production. The Oil Stabilization Fund saw its surplus diminish because of Law 633 of 2000, which allowed local governments to use savings in the Fund to pay or prepay debts owed to the financial sector. Lastly, the social-security sector was affected by a significant widening of the deficit in the health-care segment, as more people withdrew from coverage provided by some entities.

The central government's finances registered a deficit of 9,575 billion pesos in 2001, equivalent to 5.1% of GDP, and lower than the deficit in 2000 by 0.8% of GDP. Table 13 shows that total revenues grew by 22.4% and tax revenues by 26.2%. The fastest growing tax items were the financial-transactions levy (35.5%), the gasoline tax (33.6%), and income tax (30.6%). Buoyancy in these taxes and in internal VAT is associated with the tax reform approved at the end of 2000, which modified some tax rates and tax bases[9]. The economic downturn, however, caused tax receipts to fall short of the government's initial target by 500 billion pesos.

On the side of expenditures, total outlays increased by 18.3%, with interest payments on debt expanding by 11.2%, operating costs by 18.0%, and investment by 27.9%. Among operating costs,

[9] In the case of the gasoline tax, the rise in receipts is explained by inclusion of some special contributions under this item.

TABLE 12
CONSOLIDATED PUBLIC-SECTOR FISCAL BALANCE

Item	Billions of pesos			Percentage of GDP		
	2000	2001 (pr)	2002 (proj)	2000	2001 (pr)	2002 (proj)
Electricity	238,0	273,0	386,0	0,1	0,2	0,2
Emcali (Cali municipal utilities)	n.d.	126,0	80,0	n.d.	0,1	0,0
EPM (Medellín municipal utilities)	n.d.	333,0	460,0	n.d.	0,2	0,2
FAEP (oil stabilization fund)	1.622,0	517,0	(814,0)	1,0	0,3	(0,4)
Ecopetrol	1.272,0	534,0	984,0	0,7	0,3	0,5
Telecom	(41,0)	35,0	124,0	(0,0)	0,0	0,1
Other entities 1/	568,0	34,0	763,0	0,3	0,0	0,4
Social security	809,0	755,0	899,0	0,5	0,4	0,4
Regional & local	(171,0)	624,0	1.243,0	(0,1)	0,3	0,6
National Coffee Fund	(275,0)	(103,0)	(64,0)	(0,2)	(0,1)	(0,0)
1. Subtotal decentralized sector	4.022,0	3.128,0	4.061,0	2,4	1,7	2,0
2. Central government	(10.080,0)	(9.575,0)	(9.687,0)	(5,9)	(5,1)	(4,7)
A. Total nonfinancial public sector (1+2)	(6.058,0)	(6.447,0)	(5.626,0)	(3,6)	(3,4)	(2,7)
B. Banco de la República cash profit/loss	877,0	1.327,0	879,0	0,5	0,7	0,4
C. Fogafin cash profit/loss	30,0	299,0	256,0	0,0	0,2	0,1
D. Financial restructuring costs	(666,0)	(1.303,0)	(969,0)	(0,4)	(0,7)	(0,5)
E. Adjustments	(45,0)	0,0	0,0	(0,0)	0,0	0,0
F. Total public-sector consolidated deficit (A+B+C+D+E)	(5.862,0)	(6.124,0)	(5.461,0)	(3,5)	(3,3)	(2,6)

(pr): Preliminary.
(proj): Projection.
n.a.: Not available.
1/ Metro de Medellín; ETB including among others and EAAB (Bogotá telecommunications and water); ICA (farm institute); Incora (land reform); Invías (roads); ICBF (family welfare); and SENA (vocational training).

Source: Fiscal Policy Council (Confis).

personal services rose by 9.2%, general expenditures by 35.1%, and transfers by 19.0%. As explained in the previous Report, the surge in general expenditures was connected with procurement of military equipment. Net loans totaled 1,257 billion pesos.

The government's deficit was largely financed from foreign and domestic loans, and the transfer of profits produced by the Banco de la República's operations. Net foreign financing came to 8,972 billion pesos, resulting from disbursements totaling 12,756 billion, less 3,784 billion in amortizations. Net domestic financing amounted to 6,300 billion pesos, resulting from 14,409 billion in disbursements, less amortizations totaling 8,109 billion. Sales of Treasury paper during the year produced 13,527 billion pesos.

Table 13
Central Government
(Billions of Pesos)

	2000	2001 (pr)	2002 (proj)	Annual % change	
				2001/2000	2002/2001
I. Total revenues (A + B + C + D)	22.860,0	27.760,0	29.892,0	22,4	7,7
A. Tax revenues	19.637,0	24.777,0	27.161,0	26,2	9,6
Income tax	7.824,0	10.220,0	11.421,0	30,6	11,8
Internal VAT	5.585,0	6.793,0	7.552,0	21,6	11,2
External VAT	2.535,0	2.895,0	3.182,0	14,2	9,9
Customs	1.744,0	2.246,0	2.286,0	28,8	1,8
Gasoline tax	833,0	1.113,0	1.104,0	33,6	(0,8)
Financial-transactions levy	1.037,0	1.405,0	1.519,0	35,5	8,1
Other	79,0	105,0	97,0	32,9	(7,6)
B. Non-tax revenues	489,0	340,0	293,0	(30,5)	(13,8)
C. Special funds	431,0	334,0	331,0	(22,5)	(0,9)
D. Capital income	2.123,0	2.309,0	2.107,0	8,8	(8,7)
Financial returns	837,0	892,0	902,0	6,6	1,1
Financial surpluses	1.153,0	1.295,0	1.076,0	12,3	(16,9)
Other	133,0	112,0	118,0	(15,8)	5,4
II. Total expenditures (A + B + C + D)	32.942,0	38.963,0	40.438,0	18,3	3,8
A. Interest payments	6.630,0	7.375,0	8.870,0	11,2	20,3
External	2.256,0	3.083,0	3.838,0	36,7	24,5
Internal	4.374,0	4.292,0	5.032,0	(1,9)	17,2
B. Operating costs	22.802,0	26.906,0	29.074,0	18,0	8,1
Personal services	4.675,0	5.105,0	5.299,0	9,2	3,8
General expenditures	1.375,0	1.858,0	1.804,0	35,1	(2,9)
Transfers	16.752,0	19.943,0	21.971,0	19,0	10,2
C. Investment	2.678,0	3.425,0	1.005,0	27,9	(70,7)
D. Net loans	832,0	1.257,0	1.489,0	51,1	18,5
Cash deficit or surplus	(10.262,0)	(11.203,0)	(10.546,0)	9,2	(5,9)
III. Accrued adjustments	182,0	1.628,0	859,0	794,5	(47,2)
IV. Deficit or surplus (I - II + III) 1/	(10.080,0)	(9.575,0)	(9.687,0)	(5,0)	1,2
Financial restructuring costs	666,0	1.303,0	969,0	95,6	(25,6)
V. Financing (A + B + C + D)	(10.746,0)	(10.878,0)	(10.656,0)	1,2	(2,0)
A. Net external credit	3.675,0	8.972,0	877,0	144,1	(90,2)
Disbursements	5.731,0	12.756,0	5.978,0	122,6	(53,1)
Amortizations	2.056,0	3.784,0	5.101,0	84,0	34,8
B. Net domestic credit	6.638,0	6.300,0	3.253,0	(5,1)	(48,4)
Disbursements	12.006,0	14.409,0	11.298,0	20,0	(21,6)
Amortizations	5.368,0	8.109,0	8.045,0	51,1	(0,8)
C. Banco de la República profits	516,0	1.453,0	1.022,0	181,6	(29,7)
D. Other	(83,0)	(5.847,0)	(5.504,0)	6.944,6	(194,1)
VI. Deficit as percentage of GDP	(5,9)	(5,1)	(4,7)		

(pr): Preliminary.
(proj): Projection.
1/ Does not include financial restructuring costs.
Source: Fiscal Policy Council.

III

International Context

A. General Aspects

The outlook for economic growth deteriorated further over the fourth quarter, with the economies of the United States and Japan officially in recession, and the euro area in a steep downturn. Global growth is expected to remain weak over the first half of 2002 but to begin to recover in the second half (Table 14).

Inflation fell in most countries during 2001, driven down by lower oil prices and a lessening of inflationary pressures from demand. Encouraging price developments allowed central banks to ease monetary policy to a greater or lesser extent. Thus, for example, the US Federal Reserve Board reduced its intervention rate by 475 basis points in the past 12 months, while the European Central Bank (ECB), with a less aggressive monetary policy, cut its rate by 150 points. And the Bank of Japan continued to provide markets with ample liquidity at zero interest.

On the basis of economic-growth projections for Colombia's main trading partners, discussed in detail below, the country's foreign trade is expected to have shown a 1.4% weighted overall expansion by volume in 2001; that is 0.3 percentage points lower than the 1.7% growth predicted in the previous Inflation Report. Weighted growth in 2002 is also expected to be 1.4%.

1. United States

The US economy started to contract in March. Real GDP shrank over the third quarter by an annualized quarterly rate of 1.3%, its biggest shrinkage since

Table 14
Actual and Forecast Growth (*)
For Colombia's Main Trading Partners

	2000	2001	2002
World			
United States	4,1	1,0	0,7
Euro zone	3,4	1,5	2,0
Japan	2,2	(0,4)	(1,0)
Latin America			
Argentina	(0,5)	(2,7)	(1,1)
Brazil	4,4	1,8	2,0
Chile	5,4	3,3	3,0
Ecuador	2,3	5,2	3,8
México	6,9	(0,4)	1,2
Venezuela	3,2	2,7	1,8
Colombia	2,8	1,4	2,4

(*) IMF forecasts, December 2001.

the third quarter of 1991. Most components of aggregate demand plummeted, the contraction being particularly severe in exports (19.4%) and private investment (10.5%). And though public and private consumption and household investment continued to expand, they did so much more slowly than in the previous quarters (Figure 66).

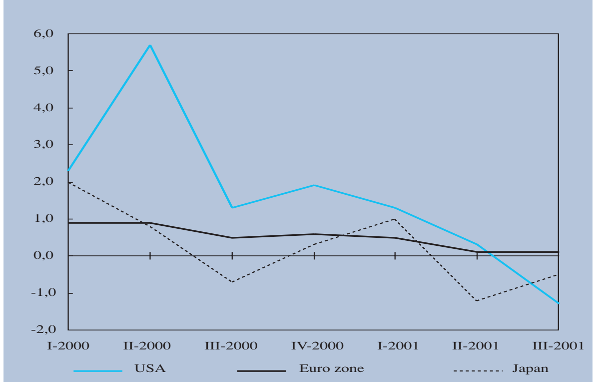
Risk factors persisting today suggest that the US economy contracted further over the fourth quarter of 2001. In its report dated November28, the Fed stated that manufacturing continued to weaken in October and early November, with falls in orders and production. According to the Fed[10], industrial production decreased by 0.9% in October and by 0.3% in November. Capacity utilization was 74.7% in November, 6 percentage points lower than a year earlier and 7.4 points below the average in 1967-2000. The US unemployment rate continued to rise rapidly, from 5.4% in October to 5.8% in December, the highest rate in six years. The fourth-quarter rise in unemployment claims was also the highest since the early 1990s.

Although a good many of the country's economic indicators showed signs of weakening in the third and fourth quarters, consumption remained relatively strong, becoming the engine of economic growth. The factors behind positive behavior include the United States' rapid and relatively successful military campaign in the Afganistan -with its positive effect on consumer sentiment-, lower oil prices, and the US economy's low interest rates.

Various international analysts believe that, given the relative resilience of consumption, the downturn can be expected to be a short one. This optimistic expectation is strengthened by other favorable factors, such as lower fuel prices, the end of the inventory-correction cycle, upturns in consumer-sentiment indicators, fiscal stimuli, and the Fed's easing of monetary policy.

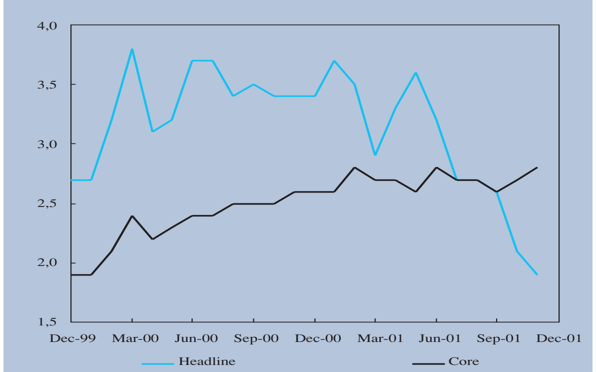
10 Information taken from the Fed's *Beige Book*, containing data gathered before November 19, 2001.

FIGURE 66
ANNUALIZED QUARTERLY GDP GROWTH: USA, EURO ZONE, JAPAN



Source: Bloomberg.

FIGURE 67
UNITED STATES
HEADLINE AND CORE INFLATION RATES



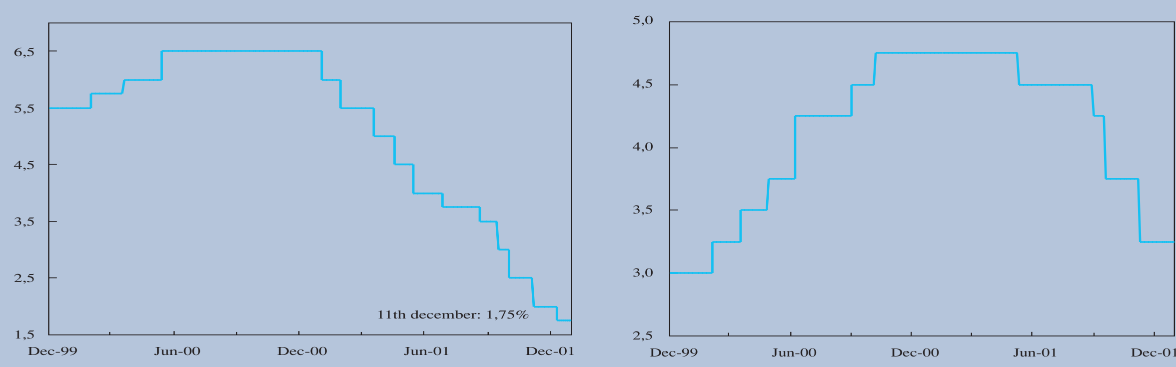
Source: Bloomberg.

Inflation rates dropped further over the fourth quarter. The consumer-price index showed zero growth in the month of November, while annual headline inflation stood at 1.9% and annual core inflation at 2.8% (Figure 67). With inflation under control, the Fed was able to pursue its resolute rate-cutting policy during the final months of the year. The latest cut, of 25 basis points, was made on December 11, leaving the intervention rate at 1.75%.

The drop in inflation, together with low inflation expectations, lower capacity utilization and economic recession, suggests a controlled inflation rate all through 2002. There will thus be scope for at least

FIGURE 68

US FEDERAL FUNDS INTEREST RATE | **EURO ZONE REFI INTEREST RATE**



Source: Bloomberg.

one more rate cut in early 2002, as noted in recent statements by members of the Fed's open-market committee (Figure 68).

Given the low level of interest rates and the buoyancy still shown by consumption, signs of recovery are expected to appear in the US economy in the first half of 2002 and become stronger in the second half, leading to positive growth. The US economy is currently expected to show a growth rate of 1.0% for 2001 and 0.7% in 2002 (Table 14).

2. Euro area

The euro area's growth outlook deteriorated over the fourth quarter by much more than predicted in the previous Report. GDP for the 12 countries of the area grew by 0.1% in the third quarter, as it had in the second.

This expansion was largely fueled by public and private consumption. Investment growth was moderate; and the real external balance continued to expand because the fall in imports more than made up for the decline in exports. Imports fell mainly in response to weak domestic demand, while lower exports were the outcome of worsening global economic conditions (Figure 66).

Growth in the euro zone, as in the United States, showed signs of contraction during the fourth-quarter. The industrial-output index dropped by an annual rate of 2.7% in October. The PMI index[11] fell again in November, remaining below 50 points for 18 months in a row and diminishing the outlook for improvement in industrial production. Consumer-confidence indicators continued to deteriorate, partly because of worsening labor-market conditions. The unemployment rate stood at 8.4% in September and October, up from 8.3% in August.

Euro-area countries currently face major obstacles that could curb growth in 2002. In the first place, the world economic downturn has cancelled out the positive expansionary effect of the euro's continuous decline so far this year and considerably weakened the region's exports. In the second place, firms have been prompted by poor balance-sheet results to try and cut costs, thereby producing adverse effects on the euro-zone labor market, lowering available household income and hence reducing consumer spending. Lastly, self-imposed public-spending rigidity in the area's 12 countries, within the framework of the "Stabilization Plan," prevents them from stimulating the economy through higher public spending. Add to the above, the ECB's reluctance to cut interest rates, which has made the region's near future more uncertain.

[11] Purchasing Managers' Index. It measures the level of activity in the manufacturing sector.

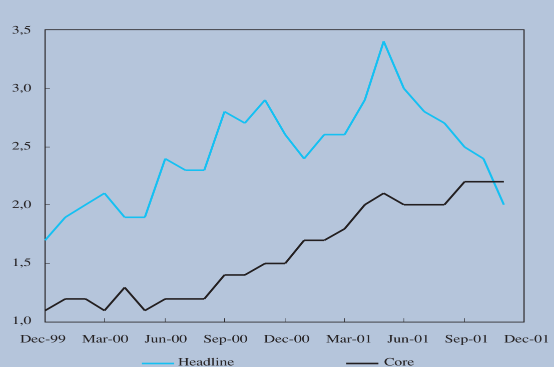
The euro countries' growth results may not be particularly encouraging, but their price results certainly are. Annual inflation for the area dropped over September, October and November from 2.5% to 2.4% to 2.1%. the lowest rates since June 2000 (Figure 69). The drop was mainly produced by an easing of inflationary pressures from demand and by lower food and energy prices. According to international analysts, the ECB's 2% inflation target was probably reached by December, eliminating the dilemma between economic growth and price stability, which has restrained the application of looser monetary policy, and leaving the way open to a rate cut of at least 50 basis points by June 2002.

To sum up, growth in the euro area probably continued to be weak in the fourth quarter of 2001 but is expected to pick up gradually in 2002, in line with recovery in the US economy. The IMF predicts a growth of 1.5% for 2001 and about 2.0% for 2002.

3. Japan

Japan's economic situation has deteriorated in the past six months, taking the country into its fourth recession in ten years, with no upturn in sight for 2002. The economy contracted again in the third quarter of 2001, this time by a quarterly rate of 0.5%. The forecast for the whole year is a shrinkage of about 1.0%, with further contraction expected in 2002 (Figure 66).

FIGURE 69
EURO ZONE HEADLINE AND CORE INFLATION RATES



Source: Bloomberg.

To judge from different information variables and economic indicators, the downturn continued over the fourth quarter. Machinery orders shrank by a monthly rate of 23.0% in October, company balance sheets continued to show loss, share prices plummeted, and private-credit demand continued to fall rapidly, suggesting a collapse in private investment. Industrial production, too, decreased further, reflecting both contraction in aggregated demand and accumulation of large inventories.

Both domestic demand and external demand have weakened. On the domestic front, retail sales dived in October, and the situation does not appear to have changed in the following months, judging from the latest estimates of car sales, which point to a fourth-quarter plunge of about 20% relative to the same period the year before. Indicators of consumer sentiment, too, have continued to decline, because of rising unemployment. In November, the unemployment rate climbed to 5.5%, the highest since 1960. On the external front, the global slowdown and the cycle of inventory adjustment of technology-related goods have made the economic outlook more uncertain, so that no upturn is expected in Japanese exports, at least not in the short term.

Domestic prices continued their rapid decline, as a result of lower oil and import prices. In October, November and December, headline inflation stood at -1.1%, -1.4% and -1.2% respectively, while core inflation (headline excluding fresh food) stagnated at around -1.0% (Figure 70). With the economy continuing to deteriorate, no reversal is to be expected in this declining inflation trend. In fact, the Bank of Japan has indicated concern over the possibility of the economy's going into a deflationary spiral.

The BOJ therefore continued to provide the economy with ample liquidity in the final months of 2001, keeping its monetary target at over six trillion yen, with the intervention rate thus still hovering around zero. It is currently speculated that the BOJ might raise the monetary target. But international analysts think that raising the target would have no direct

Figure 70
Japan Headline and Core Inflation Rates

Source: Bloomberg.

impact on economic activity and might only produce a positive marginal effect on share prices.
They are also agreed that economic recovery in Japan will depend exclusively on implementation of structural reforms to the financial system. As explained in our previous Report, however, such reforms might cause GDP to contract by about 5.0% in the short term. And analysts estimate that they would lead to the loss of a million jobs, a fall of about 20%in the Nikkei share index, and a big depreciation of the yen. So, it is still highly uncertain whether they will be carried out.

4. Latin America

The fourth quarter brought further deterioration of growth prospects for the region, but the most striking development in this period was that international markets began to make a distinction between Argentina's plight and the situation of the other Latin American countries. Unlike the Mexican crisis of 1994 and the Brazilian crisis of 1999, Argentina's economic catastrophe did not immediately cause greater instability in other countries of the region, but it is the biggest risk they face, especially because of the negative effects it may eventually have on capital inflows and exchange rates.

The Argentine situation is not the only negative shock currently facing the region. Falling prices of export commodities (including oil) and weak external demand, -which have affected the region's exports-, and political and public-order problems are other risk factors curbing economic recovery in the region.

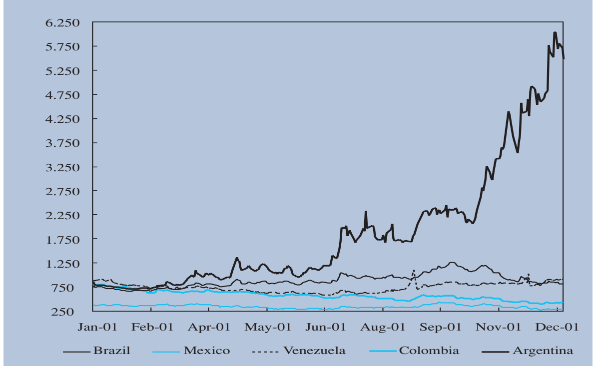
By the end of 2001, Argentina's economic and political situation was worse than predicted in the previous Report. On the fiscal front, application of a the so called "zero-deficit law[12]" in circumstances of weak economic activity meant that a substantial drop in tax revenues had to be balanced by even more drastic cuts in the country's already diminished public spending. The upshot was considerable social unrest as well as a further weakening of the economy. The country's unsustainable foreign-debt situation led the Argentine government to announce, at the beginning of December, its intention of using pension-fund money to meet its external obligations. In an effort to prevent capital flight, the government also decreed a series of financial restrictions, including central-bank authorization for transferring more than $1,000 abroad; full control over interest rates; and a cap of $250 a week on bank withdrawals. The resulting exacerbation of social unrest caused the resignation of President de la Rúa and his entire economic team.

It was clear, after the fall of the De la Rua's government, that the strategy to be followed would include a moratorium on sovereign debt and an end to the convertibility scheme[13]. Argentina is currently expected to devalue its currency by 30% to 40% and, after a few months, to let its exchange rate float freely. A new package of measures is expected to include a large cut in public spending, to help raise the level of activity. But the country's delicate economic circumstances and uncertain political situation suggest that its economy has not yet touched bottom. International analysts therefore expect a

12 A law passed by the Argentine Congress whereby the government undertook not to spend more than the revenues it collected.

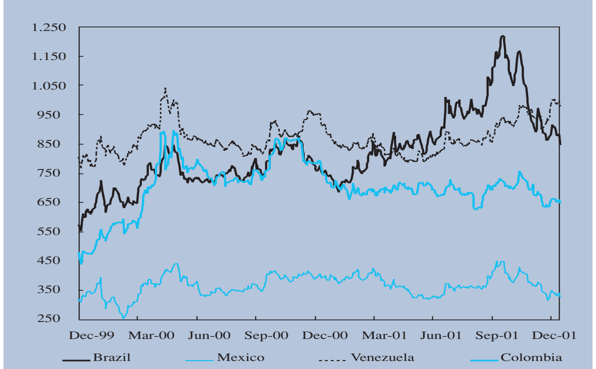
13 As this Report was going to press, the new government of Argentina, under President Duhalde, announced a 40% devaluation, and a moratorium was officially declared on public debt.

Figure 71
Spreads on Latin American Sovereign Debt
(Data to December 31)



Source: Bloomberg.

Figure 72
Spreads On Latin American Sovereign Debt
Excluding Argentina
(Data To December 31)



Source: Bloomberg.

2.7%[14] contraction for 2001 and continued shrinkage in 2002, in which case Argentina will have suffered five years of economic contraction.

Financial turbulence in Argentina has so far had limited effect on Brazil's economy. Half-way through the fourth quarter, Brazil's interest rates, sovereign-debt spreads (Figures 71 and 72) and exchange rate deteriorated, but application of a strict monetary policy and a lowering of the current-account deficit contained the currency's depreciation and calmed the markets. Although internal shocks, such as an energy crisis, and external shocks have now lowered predictions for the Brazilian economy's growth in 2001, various factors, including healthy export behavior, a strong central-bank commitment to the 2002 inflation target, and higher foreign direct investment, suggest that growth may improve in 2002, to an expected rate of around 2.0%

Growth predictions for the Andean countries have also been revised down, because of falling oil prices, political uncertainty, and foreign-financing needs. Lower interest rates in the United States have undeniably benefited these economies, as evidenced by stable spreads on 10- and 30-year sovereign debt, but the global downturn has reduced their exports, placing their exchange and interest rates under great pressure.

Venezuela is currently beset by two major shocks that have created uncertainty for the economy and lowered expectations about its growth in 2002. First, the country's political problems are a great impediment to growth. Passage of a package of laws, including private-property, investment and workers'-rights reforms, has increased protests by businessmen and unions. According to international analysts, this situation could reduce foreign-capital inflows and lead to exchange-rate instability. Second, lower oil prices have diminished fiscal revenue, creating setbacks to the country's necessary processes of external and fiscal adjustment (higher taxation and cuts in public spending).

Venezuela's budget and growth forecasts for 2002 are not exclusively underpinned by the oil sector. The government calculates that the oil sector will grow by 2.0%, while the non-oil sector's growth will be around 5.0%. But several international analysts think this budget is not feasible, for it could cause a sharp rise in inflation and put great pressure on the exchange rate.

Lastly, various economic indicators suggest that, though the Venezuelan economy has so far been

[14] But various international analysts think the IMF's growth projections are too optimistic. Investment banks, e.g. JP Morgan, expect a 3.8% contraction for 2001 and a 7.0% contraction in 2002.

expanding, it is now beginning to show signs of weakness in some sectors. Economic growth is therefore expected to slow from 2.7% in 2002 to around 1.8% in 2002, a lower rate than predicted a few months ago.

Prospects for growth are better in Ecuador. Lower oil prices will no doubt affect the country's fiscal revenues and involve spending cuts, but economic recovery is expected to continue, thanks to a number of positive factors, including construction of a new pipeline, successful dollarization, good inflation results, and a pickup in domestic demand.

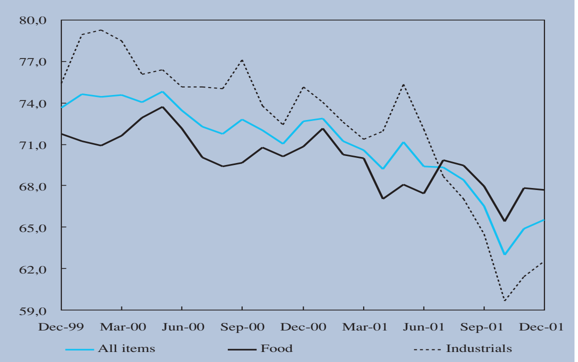
Better relations with multilateral agencies have also improved Ecuador's economic outlook for 2002. A first review of targets set with the IMF was successfully completed in early December, ensuring access to a disbursement of some $95 million. The government would like to sign a new agreement with the IMF for a further $300 million. International analysts consider implementation of such an agreement to be feasible. It would involve major fiscal reforms to ensure economic stability for the coming years. Ecuador should thus be able to grow by almost 3.8% in 2002. This is a lower rate than in 2001 but one of the highest projections in the region.

Argentina aside, Mexico is the Latin American country that suffered the strongest downturn in 2001. The major shocks currently besetting Mexico include the negative effect of the US recession on Mexican exports to the US market (estimated at around 89% of the total), falling oil prices, and political uncertainty surrounding fiscal reform. These factors have affected growth predictions to such as extent that international analysts now expect the Mexican economy to have contracted by 0.4 % in 2001 and to grow by barely 1.2% in 2002.

B. Commodity Prices

Commodity prices fell sharply in 2001, particularly in the second half of the year. *The Economist*'s overall average commodity price index dropped by 6.4% over the year from its level in 2000. (Figure 73).

Figure 73
Monthly Main Commodity Price Index
(1995 = 100)



Source: *The Economist*.

The fall occurred mostly in industrial prices, which plummeted from July on, their average in *The Economist* index showing a 10.1% drop in 2001. The industrials' drop was in turn largely caused by a steep decline in the metals index (12.3%), attributable to the world economic downturn. The food-price index also declined in 2001, by 3.5%.

Many analysts expect commodity prices to continue their downward trend in 2002 until, according to their projections, demand picks up in the second quarter.

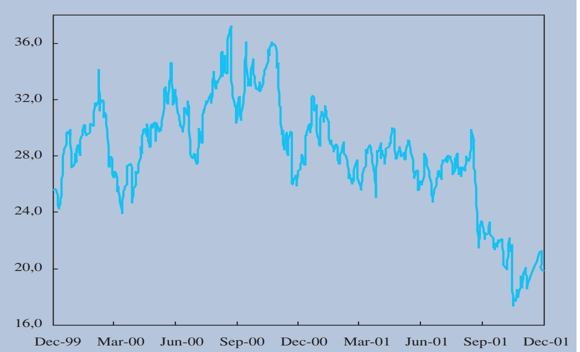
2. Oil

Thanks to OPEC's price-stabilizing measures[15], the price of crude oil remained within the range of the Organization's band mechanism[16] over much of the year. But, after the September-11 terrorist attacks, the price rose very briefly before plunging below the band's lower limit. It averaged $22.2 a barrel in October, $19.6 in November, and $19.3 in December.

15 OPEC reduced production quotas three times in 2002, by a total of 3.5 million barrels a day.

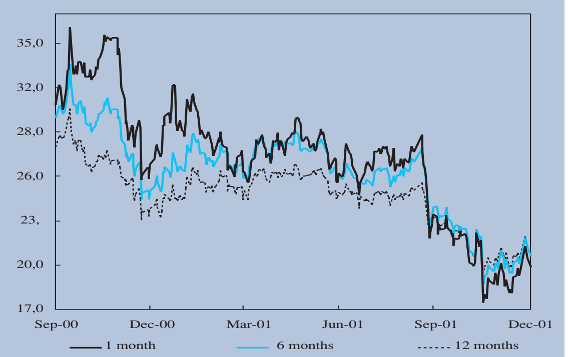
16 Under OPEC's band mechanism, the price for its basket of crudes should remain between $22 and $28 a barrel, roughly equivalent to $25 - $30 in terms of the US West Texas Intermediate (WTI) indicator.

FIGURE 74
WTI OIL PRICE NEW YORK STOCK EXCHANGE
(DOLLARS/BARREL)



Source: Bloomberg.

FIGURE 75
WTI OIL FORWARD SALES PRICES NEW YORK STOCK EXCHANGE
(DOLLARS/BARREL)



Source: Bloomberg.

The December average was 32.3% lower than a year earlier (Figure 74).

Falling demand was the main cause of the fourth-quarter drop in crude prices. Specifically, the decline in air traffic after September 11 sharply reduced fuel consumption of 462,500 barrels a day. A further decision taken by OPEC at its latest meeting was to suspend the price band it had maintained since March 2000.

It is uncertain how crude prices will behave in 2002. Much will depend on two factors: first, how effective the production-cut decisions will be in actually reducing crude supply; and, second, how fast the world economy will recover. Although non-OPEC countries are not expected by some analysts to reduce crude supply by much more than 100, 000 a day, it is reckoned that OPEC will cut its supply by about a million barrels a day.

It is likely therefore that oil stocks will decrease during 2002 and push crude prices up, especially when the world economy starts to recover. The price of crude oil is thus expected to be higher at the end of 2002 than it was in December 2001, though the average price forecast for 2002 ($23 to $24) is lower than the 2001 average.

Over the fourth quarter, prices for forward sales contracts on the New York Stock Exchange kept in line with the quarter's oil-price movements. By the end of December, per-barrel prices for one-, six- and twelve-month forward contracts were $19.8, $20.5 and $20.8 respectively, lower than three months earlier, when they stood at: $23.4, $23.8 and $23.2) (Figure 75). Thus, prices in December for six- and twelve-month contracts suggest that oil prices in 2002 are expected to be lower than in 2001.

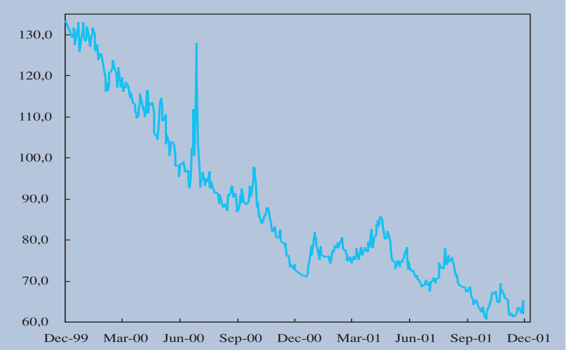
2. Coffee

In 2001, world coffee prices continued the downward trend displayed in 2000. Despite application of the Coffee Retention Plan by the Association of Coffee Producing Countries[17], the world price fell all through the year, down to an average of 72.2 cents a pound, 29.4% lower than the mid-2000 average of 102.6 cents a pound (Figure 76).

In the fourth quarter specifically, the average price of coffee decreased by 9.7% relative to the third quarter, to 64.2 cents a pound. This movement was reflected by forward sales prices, which dropped from 48.3, 52.6 and 57.0 cents a pound respectively for one-, six- and 12-month contracts at the end of

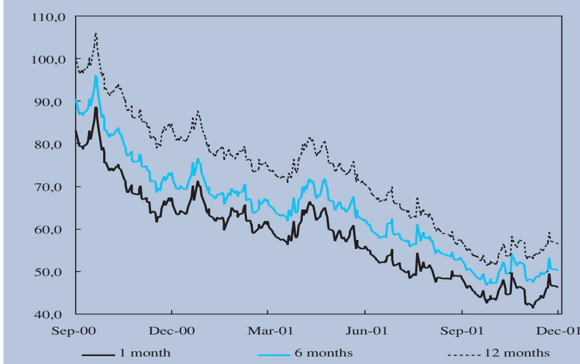
[17] The ratified members of the Association of Coffee Producing Countries are Brazil, Colombia, Costa Rica, El Salvador, India, Indonesia, Venezuela, Angola, Ivory Coast, Kenya, Tanzania, Togo, Uganda and the Democratic Republic of Congo.

FIGURE 76
COLOMBIAN ARABICA COFFEE PRICE NEW YORK STOCK EXCHANGE
(CENTS/POUND)



Source: Bloomberg.

FIGURE 77
ARABICA COFFEE FORWARD SALES PRICES
NEW YORK STOCK EXCHANGE
(CENTS/POUND)



Source: Bloomberg.

September to 46.2, 50.1 and 56.4 cents a pound at the end of December (Figure 77).

As explained in previous Reports, the sharp fall in world coffee prices over the past two years is largely attributable to overstocking in consuming countries. The market's present conditions do not appear to point to a rebound in coffee prices in 2002, so they are expected to average 70 cents a pound for the year.

IV

Inflation Forecasts

This chapter presents inflation forecasts for 2002 made on the basis of developments in the past three months, together with the first predictions for the year 2003.

A. Inflation-forecasting Assumptions

This Report's forecasting assumptions are not much different from the September Report's, as regards the main macroeconomic variables. The exchange rate is assumed to remain reasonably stable in 2002, with a real rate similar to that registered in 2001. The grounds for this assumption include the government's external deficit-financing program, a reduction in private-capital outflows, and monetizations of foreign-currency assets of FAEP (oil stabilization fund) in the first half of the year. These factors may make up for an expected widening of the current-account deficit in the balance of payments. Nominal devaluation in 2003 could be a little higher than in 2002, depending, among other things, on the government's external financing of the fiscal deficit, and on a decrease in oil exports. With domestic inflation expected to be lower, a higher nominal devaluation would mean a small rise in the real exchange rate.

The economy is assumed to grow at a faster pace in 2002 and 2003 than it did in 2001,according to the government forecasts. And growth in private domestic demand is expected to be stronger than in 2001, for reasons including: lower interest rates, exchange-rate stability, an upturn in construction, and a decrease in unemployment. In contrast, the public sector is not expected to be a source of stimulus for much of the period in question, owing to implementation of the fiscal adjustment program by the present government and most likely by the next.

Stronger growth over the next two years is not expected to be an obstacle to meeting inflation targets. For, despite an economic upturn, the assumed increase in GDP is not sufficient to raise actual GDP to the level of potential GDP over this period. Which means that rising demand can be accommodated without causing prices to go up by more than the inflation targets set by the Board of Directors of the Banco de la República. Besides, the fact that inflation targets have been met in recent years has lent greater credibility to monetary policy, so that inflation may continue to fall even if the economy were to operate close to its potential capacity.

With regard to other assumptions, the biggest change relative to the September Report has to do with weather conditions. The Niño phenomenon is no longer expected to occur in the first half of 2002. Three months ago there seemed to be some likelihood of its emerging in December and lasting to mid-2002. But, according to various environmental agencies, normal rainfall in the last two months of 2001 has ruled out the Niño's presence, at least for a time, and it is believed that if it occurs at all in 2002 it will not do so until the end of the year. In this case, its effects would be felt most strongly in the first half of 2003. Accordingly, the forecasts presented below assume a 25% probability of the Niño's being present in 2003. Its presence then would reduce rainfall moderately in the first quarter, decrease farm supply in those months, and raise food prices in the following months.

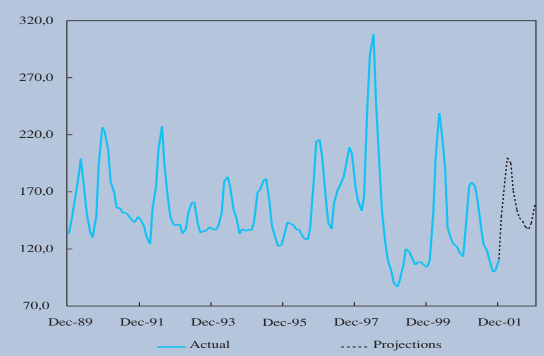
Although the Niño will not be playing a major part in determining farm prices in the first half of 2002, food prices are still reckoned to produce inflationary pressures then, for two reasons. First, this Report, like the previous one, assumes that beef prices will rise in 2002 because the cattle-retention stage will still be in progress. But the rise will be smaller than in 2001 and will be concentrated in the first half of the year. Beef prices will become more stable in the second half of 2002 and may even come down in 2003, thanks to an expected pick-up in supply as cattle-breeding enters the liquidation stage. This would help to reduce consumer inflation in 2003.

Second, sharp increases in potato prices are expected to generate inflationary pressures in early 2002. These increases, which were already beginning to appear at the end of December 2001, would be the outcome of less planting in the second half of 2001 owing to discouragingly low potato prices over the whole year (Figure 78). In the second half of 2002, however, potato prices should come down again, displaying the usual behavior pattern of this type of agricultural produce.

Higher beef and potato prices in 2002 and the possible occurrence of the Niño in 2003 are incorporated as assumptions in the food-price satellite model, whose results are shown in Figure 79. The central path of this model's forecasts shows annual food inflation running high during the first two quarters of 2002. Food inflation should then begin to fall in the third quarter, down to a 7.0% average by the end of the fourth. The declining trend in food inflation is forecast to continue all through 2003, largely thanks to falling beef prices.

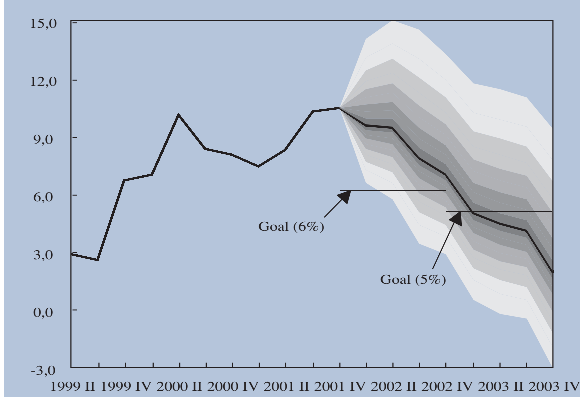
In general, the risk factors that may cause the 2002 inflation target to be missed are mostly connected with supply. Product growth could be slower than is assumed in forecasting: if the situation of violence,

FIGURE 78
RELATIVE POTATO PRICES



Source: DANE. Calculations by Banco de la República.

FIGURE 79
FOOD-INFLATION FORECASTS FOR 2002 AND 2003
(CENTRAL SCENARIO AND RISK BALANCE)



Source: Banco de la República.

Period				90% 50% 20% Central			
Dec-01	**10,4**	**10,4**	**10,4**	**10,4**	**10,4**	**10,4**	**10,4**
Mar-02	6,5	8,3	9,0	9,5	10,2	11,4	14,1
Jun-02	5,7	7,9	8,8	9,4	10,3	11,7	15,0
Sep-02	3,3	5,9	7,1	7,8	8,9	10,6	14,5
Dec-02	**2,7**	**5,2**	**6,3**	**7,0**	**8,0**	**9,6**	**13,3**
Mar-03	0,4	3,0	4,2	4,9	6,0	7,7	11,7
Jun-03	(0,3)	2,4	3,6	4,4	5,5	7,3	11,4
Sep-03	(0,6)	2,1	3,3	4,0	5,1	6,9	11,0
Dec-03	**(3,2)**	**(0,3)**	**1,0**	**1,8**	**3,0**	**4,9**	**9,3**

forecasts

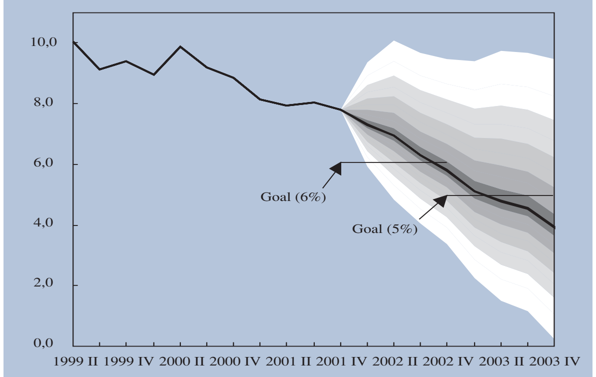
and the uncertainty prevailing in the run-up to this year's elections weaken investment and consumption; if capital inflows are lower than is implicitly assumed in financial programming exercises; or if, in general, the economies of Colombia's main trading partners remain weak or deteriorate further. The Colombian economy is seen as operating closer to its potential capacity in 2003, which means that this source of deflation will have less effect than in recent years. There is also a risk of greater devaluation, depending, among other things, on the government's external financing, the Venezuelan currency's behavior, and oil exports. The situation of violence, the behavior of capital flows and of the exchange rate, continued implementation of structural reforms, and the international context will largely determine whether the economy in 2003 does in fact grow at the faster pace now forecast by the goverment.

B. Inflation Forecasts

The latest forecasts, like those of September, indicate that the 6% inflation target for 2002 can be met. They also show inflation continuing to fall below this level in 2003, which suggests that the economy might reach a stage of virtual price stability in the not-too-distant future.

Figure 80 presents the central path and risk balance of the inflation forecast obtained from the Bank's transmission-mechanism model. This central path shows inflation averaging 5.8% in the fourth quarter of 2002, slightly higher than last September's prediction. The central forecasts for the first two quarters of the year are also a little higher now than last September, partly because some food prices (especially potato prices) are now expected to rise more strongly over these months. Inflation is predicted to continue falling steadily all through 2003, down to 3.9% in the fourth quarter. As in the September Report, the risk balance continues to show an upward bias, because of exchange-rate risks, and higher-than-expected

FIGURE 80
CONSUMER-INFLATION FORECASTS FOR 2002 AND 2003[2]
(CENTRAL SCENARIO AND RISK BALANCE)



Source: Banco de la República.

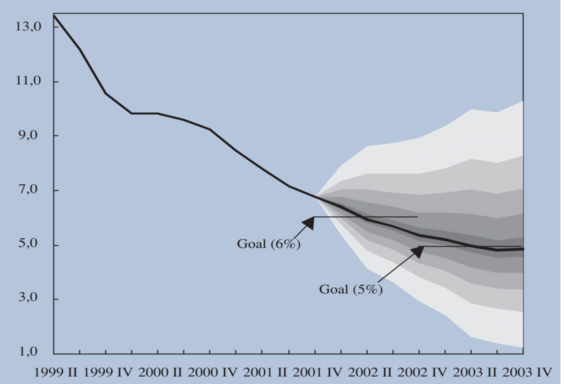
Period	90%	50%	20%	Central	20%	50%	90%
Dec-01	**7,8**	**7,8**	**7,8**	**7,8**	**7,8**	**7,8**	**7,8**
Mar-02	5,9	6,7	7,1	7,3	7,6	8,2	9,4
Jun-02	4,9	6,1	6,6	6,9	7,4	8,2	10,1
Sep-02	4,0	5,4	5,9	6,3	6,8	7,7	9,7
Dec-02	**3,4**	**4,8**	**5,4**	**5,8**	**6,4**	**7,3**	**9,5**
Mar-03	2,2	3,9	4,7	5,1	5,8	6,9	9,4
Jun-03	1,5	3,4	4,3	4,8	5,6	6,8	9,7
Sep-03	1,1	3,1	4,0	4,6	5,4	6,7	9,7
Dec-03	**0,2**	**2,4**	**3,4**	**3,9**	**4,8**	**6,2**	**9,5**

food inflation, and also because the method of combining forecasts from other models used by the Bank gives a higher inflation for December 2002 (6.4%) than the central path obtained from the transmission-mechanism model.

The central path predicted for non-food inflation (core inflation) shows it running at 5.3% in the fourth quarter of 2002 and 4.8% a year later (Figure 81). As in recent years, the big drop in core inflation this year and next will result from a persistent negative output gap.

Inflation expectations, as measured by the Bank's quarterly surveys, continued to decline in the fourth quarter of 2001. Their constant decline works in fa-

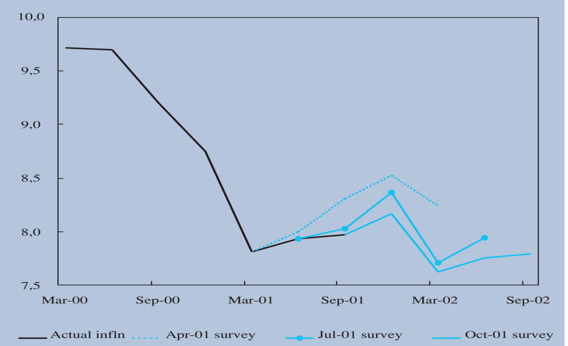
Figure 81
Non-food Inflation Forecasts for 2002 and 2003
(Central Scenario and Risk Balance)



Source: Banco de la República.

Period	90%	50%	20%	Central	20%	50%	90%
Dec-01	**6,8**	**6,8**	**6,8**	**6,8**	**6,8**	**6,8**	**6,8**
Mar-02	5,4	6,0	6,2	6,4	6,6	7,0	7,9
Jun-02	4,1	5,2	5,6	5,9	6,4	7,0	8,6
Sep-02	3,6	4,8	5,4	5,7	6,2	6,9	8,7
Dec-02	**2,9**	**4,3**	**5,0**	**5,3**	**5,9**	**6,8**	**9,0**
Mar-03	2,4	4,0	4,7	5,2	5,8	6,9	9,3
Jun-03	1,6	3,6	4,4	5,0	5,8	7,0	10,0
Sep-03	1,4	3,4	4,3	4,8	5,6	6,9	9,9
Dec-03	**1,2**	**3,4**	**4,3**	**4,8**	**5,7**	**7,1**	**10,3**

Figure 82
Actual Inflation and Expectations



Source: Banco de la República expectations surveys.

vor of meeting the 6% inflation target in 2002, insofar as it leads to lower indexed rises in prices and wages this year. Figure 82 shows the October survey's inflation expectations running lower than previous surveys', and below 8.%. Lastly, local analysts predict an average inflation of 6.9% for 2002, and foreign analysts an average of around 7.0%

Local and Foreign Analysts' Forecasts for Main Macroeconmic Variables

The latest forecasts by local and foreign analysts for Colombia's main macroeconomic variables in 2002 are reviewed below. In several cases forecasts were made before the official figure for inflation in 2001 was made known.

Forecasts for 2002

Table 1 shows 2002 forecasts in detail. Relative to predictions reported in September, the biggest changes are in growth and inflation figures. Since September, growth forecasts for 2002 have generally been revised down, with local analysts now expecting a 2.1% growth, down by 0.7 percentage points on September, and foreign analysts a 2.6% growth, down by 0.8 points.

Declining optimism about growth contrasts with rising optimism about inflation. Both local and foreign analysts have sharply reduced their inflation forecasts for 2002, the former to 6.9% and the latter to 7.0%. It is to be noted that the 0.8 percentage-point reduction relative to three months earlier was made by analysts before learning of the official inflation figure for 2001.

As regards the nominal exchange rate, local analysts expect the dollar to fetch 2,512 pesos by the end of the year, less than predicted three months ago, while foreign analysts forecast a rate of 2,537 pesos, also lower than forecast last September. The corresponding devaluation rates for 2002 would be 9.2% and 10.2% respectively.

Local analysts have substantially decreased their forecasts for the deposit rate, in line with its actual fall over the past three months. They now predict a DTF rate of 12.2% by the end of 2002.

Lastly, forecasts for the fiscal deficit in 2002 have been left unchanged. Local analysts still expect it to be 3.1% and foreign analysts 2.6%. It is to be noted that the latter's forecast is closer to the target agreed on with the IMF.

Table 1
Forecasts for Main Macroeconomic Variables in 2002

	Forecast date growth	Real GDP (%)	Inflación IPC	Nominal exchange rate (yearend)	Nominal DTF deposit rate (%)	Deficit (% of GDP): Fiscal	Deficit (% of GDP): Currt. acct.	Unemployment (%)
Local analysts								
Revista Dinero	14-Dic-01	1,8	7,0	2.609	12,0	(3,0)	(3,1)	18,0
Suvalor-Corfinsura	17-Dic-01	2,1	6,7	2.456	12,2	(3,0)	(2,8)	n. d.
ANIF	15-Ene-02	2,0	7,0	2.474	12,0	(3,0)	(3,2)	16,5
Fedesarrollo	17-Dic-01	2,5	7,0	2.509	12,5	(3,4)	(3,7)	16,7
Average		**2,1**	**6,9**	**2.512**	**12,2**	**(3,1)**	**(3,2)**	**17,1**
Foreign analysts 1/								
Goldman Sachs	20-Dic-01	2,0	7,0	2.445		(3,5)	(2,7)	
IDEA global	17-Oct-01	3,7	6,0	2.602		(1,9)	(2,6)	
J. P. Morgan	6-Dic-01	2,7	7,0	n.d.		(2,2)	(1,3)	
ABN Amro Bank	12-Dic-01	2,2	8,0	2.547		(3,0)	(1,2)	
Salomón Smith Barney	4-Dic-01	2,3	7,3	2.630		(2,9)	(3,3)	
Deutsche Bank	6-Dic-01	1,8	6,0	2.450		(3,7)	(3,3)	
Morgan Stanley	1-Mar-01	3,5	9,0	2.559		(2,5)	(2,3)	
Merrill Lynch	14-Dic-01	3,7	8,0	2.550		(2,3)	(2,1)	
Average		**2,6**	**7,0**	**2.537**		**(2,6)**	**(2,3)**	

n.a. Not available
1/ *¿Cómo nos ven afuera?"* Report by the Banco de la República's Monetary and Reserve Division), December 21, 2001.
Source:

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